Economic Indicator — April 10, 2024

March CPI: Another Sticky Inflation Report to Cap Q1

Summary

The March CPI data once again came in a bit too hot for comfort. Both headline and core CPI rose 0.4%, and although the latter increase was a "low" 0.4% gain (0.36% unrounded), the three-month annualized rate of core CPI inflation climbed to 4.5%, the fastest pace since May 2023. Jumps in gasoline (+1.7%) and electricity (0.9%) prices helped push the headline CPI higher, while a benign 0.1% increase in food prices restrained consumer inflation during the month. Core goods deflation returned in March after a brief hiatus in February, with prices for core goods falling 0.2%. A drop in used and new vehicle prices led the decline. Core services inflation remained firm at 0.5% amid sizable price increases for medical services as well as motor vehicle insurance and maintenance.

Despite the acceleration in core prices in Q1, we still expect inflation to trend lower throughout the year, but progress will likely be gradual. Shelter disinflation is still ongoing through the month-to-month noise, and lower prices for vehicles should eventually put downward pressure on vehicle-related services inflation, such as insurance. A better balance between supply and demand in the labor market has led to steady cooling in labor cost growth, and this also should help reduce services inflation as the year progresses.

That said, today's inflation data are likely to keep the FOMC's doves on the defensive while providing more ammunition to the Committee's hawks, who are increasingly of the view that there is no rush to start cutting the fed funds rate. Even if the inflation data cool gradually in the months ahead as we expect, a solid labor market and tranquil financial conditions afford the FOMC more time to await additional data that confirms inflation is on a downward-albeit-bumpy path back to 2%. **We now project two 25 bps rate cuts in Q3 and Q4 of this year as our base case for the fed funds rate.** We will publish our monthly economic forecast update tomorrow morning that will more fully flesh out our views and projections for economic growth, inflation and interest rates.

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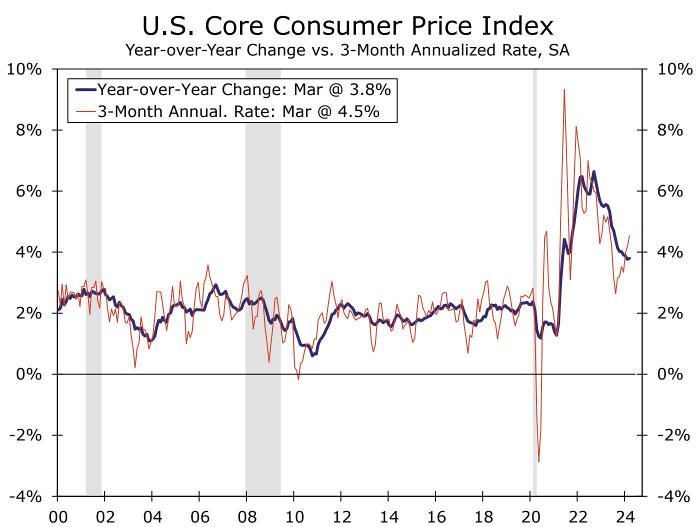
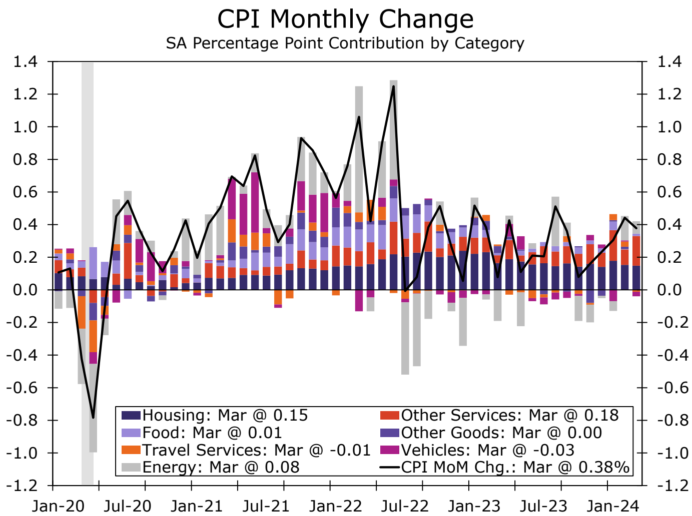


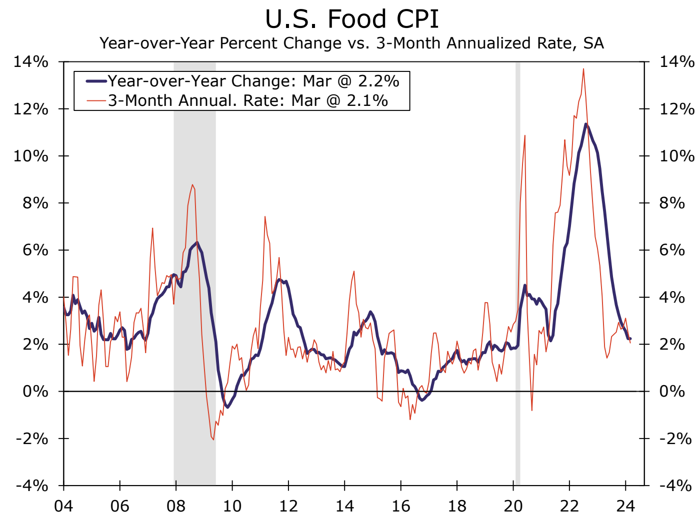
Source: U.S. Department of Labor and Wells Fargo Economics

Stubborn Services Inflation Keeping CPI Firm

Consumer price inflation came in a bit hotter than expected in March, rising 0.4% in the month. Excluding food and energy, the core CPI also increased 0.4% (0.36% unrounded). Energy prices rose 1.1% in the month, the second consecutive month in which higher energy prices boosted headline inflation. A 1.7% increase in gasoline prices and 0.9% gain for electricity drove the energy index higher. Food inflation once again proved relatively tame, registering just a 0.1% increase in March after a flat reading in February. Grocery store prices were unchanged in the month while prices for food consumed away from home rose 0.3%. Even as inflation has proved stickier for a variety of other goods and services, some relief from the breakneck pace of price increases for food has been one ongoing bright spot in recent months. Food inflation has been 2.2% over the past 12 months, a return to the pre-pandemic pace.



Source: U.S. Department of Labor and Wells Fargo Economics

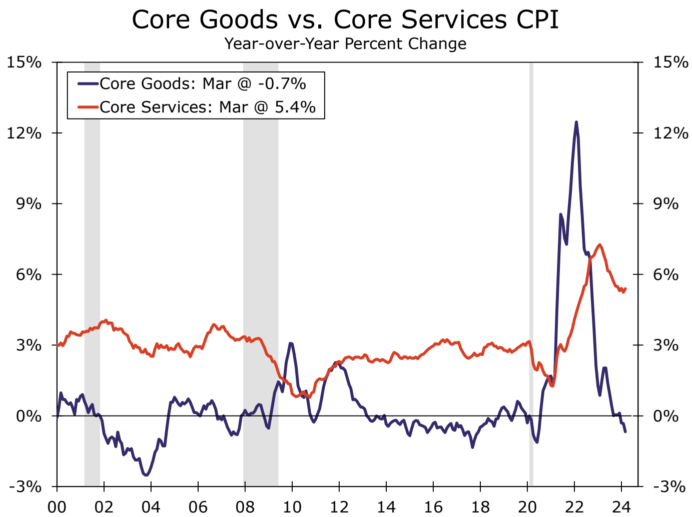


Source: U.S. Department of Labor and Wells Fargo Economics

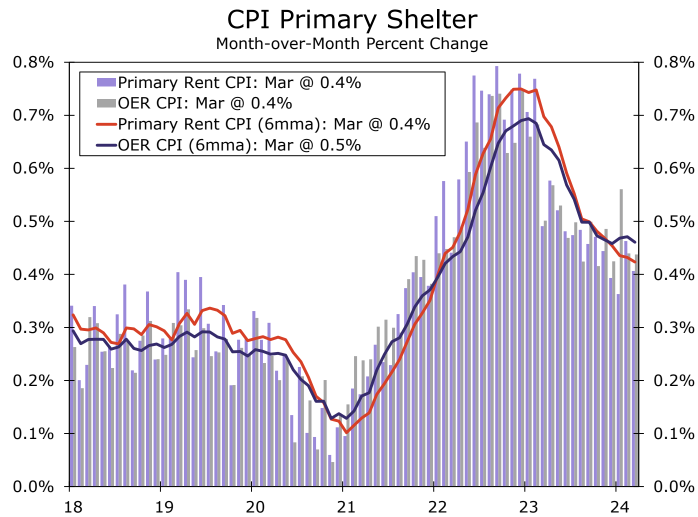
Excluding food and energy, price growth came in ever-so-slightly above expectations. As mentioned above, the core CPI rose 0.36% before rounding for a second straight month versus our estimate for a 0.33% increase. Core goods deflation resumed in March, with prices declining 0.2%. Improved production and inventory in the auto sector helped drive new and used vehicles down 0.2% and 1.1%, respectively. Other core goods prices were flat in March and are now down 0.7% over the past year—more than the 0.3% yearly decline averaged from 2015-2019.

Services inflation, however, remains relatively stubborn. The core services index rose 0.5% in March, pushing the three-month annualized rate up to 6.8%. The sharp slowdown in "spot" rents measured by private sector sources remains painstakingly slow to manifest in the CPI. Primary shelter rose 0.4% again in March, with a slight moderation in rent of primary residences set against an unchanged rate of growth in the much-larger owners' equivalent rent component. We continue to look for shelter inflation to cool this year, but another firm print in March keeps the caution flag up about the timing and extent to which housing inflation will materially slow.

Elsewhere, a rebound in medical care (+0.5%) and motor vehicle insurance (+2.6%) helped propel core services ex-housing to an increase of 0.6%. The PCE equivalent of "super core" inflation looks unlikely to pick up as sharply in March given different measurement of healthcare and vehicle insurance. We currently estimate core PCE services ex-housing will rise 0.4% in March, but we will get a fuller picture with the March Producer Price Index tomorrow.



Source: U.S. Department of Labor and Wells Fargo Economics



Source: U.S. Department of Labor and Wells Fargo Economics

Looking at the first quarter as a whole, core CPI picked up to an annualized rate of 4.2% compared to 3.4% in the final quarter of 2023. We believe the first quarter's stronger outturn reflects the often-choppy nature of monthly price measurement and that the pickup is likely to be a "bump" on the road back toward the Fed's inflation target rather than a sign that slowing inflation is reversing course. However, bumps nonetheless slow the journey down. Although progress in reducing inflation will be slower-going ahead, we expect to see inflation trend lower as the year proceeds. While the disinflationary tailwind from goods is likely to peter out as the year progresses, slower growth in services prices should keep core inflation on a downward trajectory. Moderating shelter inflation, easing pressure on goods-related services like auto insurance and cooling employment cost growth look set to provide some relief to services inflation as we move through the year. Progress is likely to be more evident in the core CPI than the core PCE, however, given the greater weighting of housing and insurance in the CPI that have contributed to a historically large wedge between the two measures.

Yet another month of strong employment and inflation data inflation suggest that the ten FOMC participants who penciled in three or more cuts at the March meeting are increasingly unlikely to see that much easing realized. We now project two 25 bps rate cuts in Q3 and Q4 of this year as our base case for the fed funds rate. We will publish our monthly economic forecast update tomorrow morning that will more fully flesh out our views and projections for economic growth, inflation and interest rates.

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