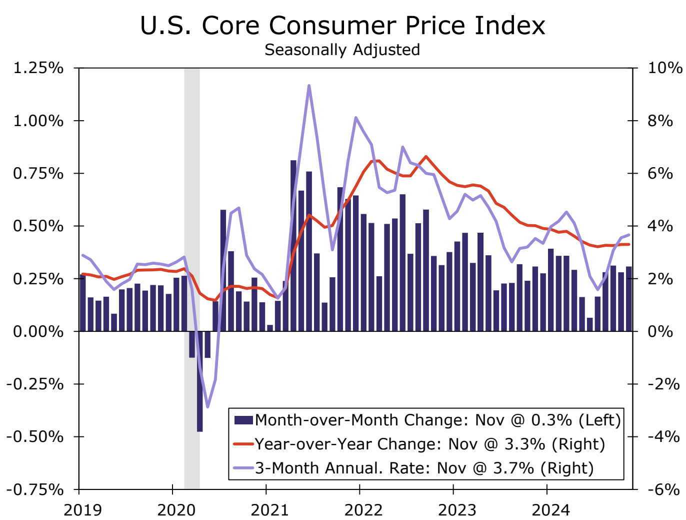
Economic Indicator — December 11, 2024

November CPI: Going Nowhere Fast

Summary

November's CPI report delivered more evidence that progress in lowering inflation has stalled. Consumer prices rose 0.3%, pushing the 12-month change up to 2.7%. While a pickup in prices for food and gasoline contributed to the headline's strength, excluding food and energy price growth also remained firm. The core index advanced 0.3% for a fourth consecutive month. *De*flation among core goods showed further signs of petering out, while *dis*inflation among core services remained painstaking slow despite a notable moderation in primary shelter inflation.

Today's inflation data probably do not represent a sea change in the outlook for the Federal Reserve. Over the course of 2024, inflation has continued to slow, albeit more gradually than many had hoped it would at the start of the year. Furthermore, supply and demand in the labor market has come into balance, and we do not view the labor market as a source of inflationary pressure in 2025. We believe the FOMC will continue to reduce the federal funds rate next year in an effort to move monetary policy to a less restrictive position. We look for 100 bps of rate cuts from the FOMC over the next 12 months, with 25 bps rate cuts at next week's FOMC meeting and the March, June and September meetings next year.



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

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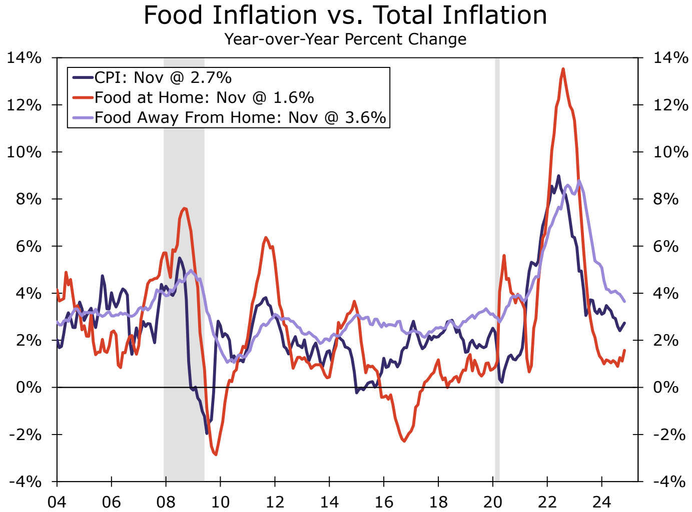
Progress Turns from Slow-Going to No-Going

Consumer prices rose 0.3% in November, the highest reading since April of this year. Falling gasoline prices have tamped down consumer price growth over the past several months, but a 0.6% increase for prices at the pump in November ended this reprieve for households. Food inflation also firmed in the month, rising 0.4% amid a 0.5% increase in grocery store prices. Prices at the grocery store check out are still only up 1.6% over the past year (chart), but the 0.5% rise in November was the largest increase since January 2023. Food and energy prices began rising sharply in 2021 and rocketed higher in 2022 in the aftermath of Russia's invasion of Ukraine. Since 2023, price growth has been normalizing in these sectors, but at this point the tailwinds from energy deflation and food disinflation appear to have run their course.



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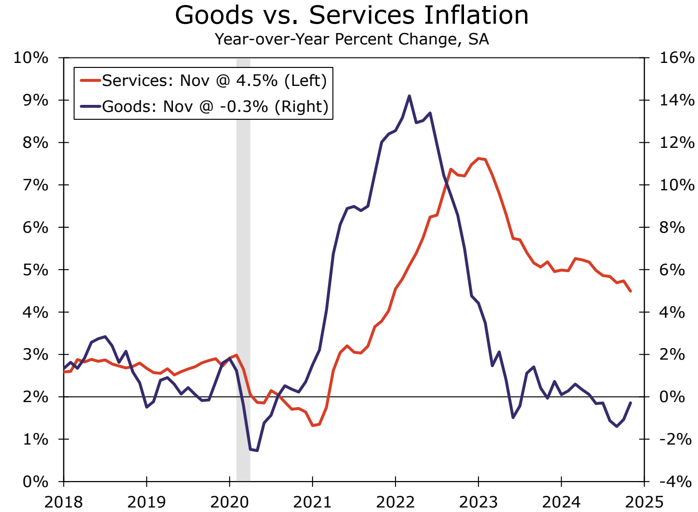
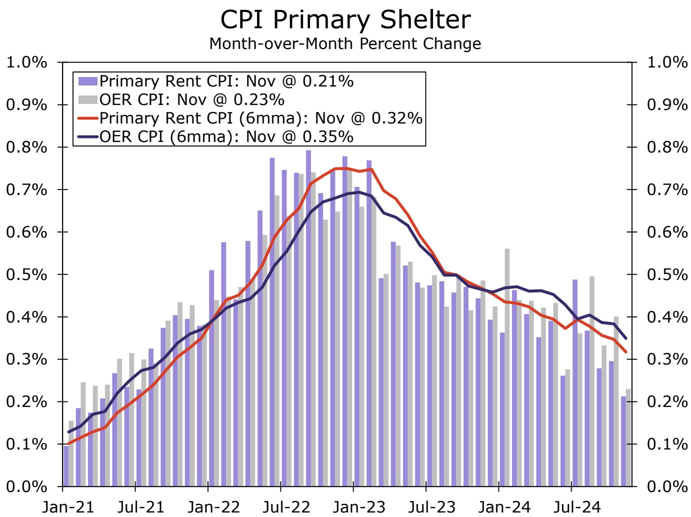


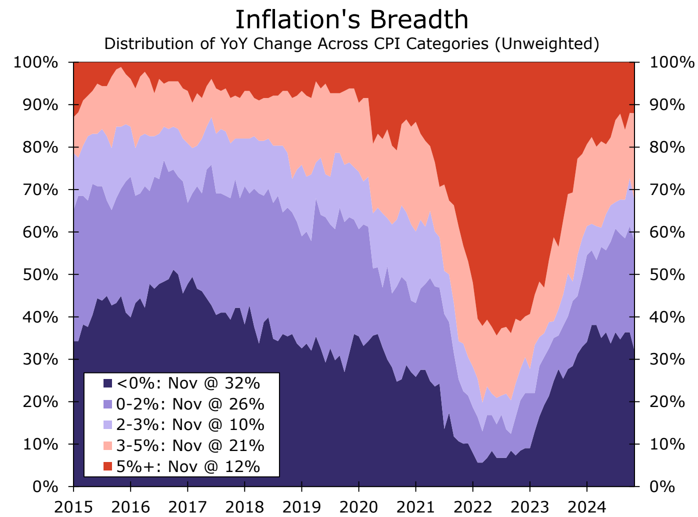
Source: U.S. Department of Labor and Wells Fargo Economics

Excluding food and energy, inflation similarly remained firm with the core index also advancing 0.3%. Goods deflation showed further signs of fading; prices rose 0.3%, which was the largest gain in a year and half. While much of the recent pickup can be traced to vehicle prices (used autos +2.0% and new vehicles +0.6%), the remaining core goods prices also edged higher over the month and are now little changed over the past year.

November's print for core services was a little more encouraging, but not wildly so. Core services prices rose 0.3%. Both rent of primary residences and owners' equivalent rent registered their smallest monthly increase in three and a half years (chart), but expectations for the downward trend in this component to kick into faster gear has been widely anticipated. Transportation inflation also eased up, with motor vehicle insurance posting another benign reading in November (+0.1%) and public transportation, which includes airfares, flat over the month. However, price growth for medical care services, the second largest component of the core index behind shelter, rose 0.4%. Meantime, recreation services were up 0.7%, which also limited the overall deceleration in services prices.



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



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

Stepping back from the details of the report, core CPI has increased 3.3% over the past 12 months. Although this represents an improvement from the 4.0% rise registered in November 2023, core CPI inflation has been stuck between 3.2% and 3.3% since June. The lack of further progress comes as key categories are no longer rowing in the same direction, and fewer categories are seeing outright deflation (chart). Food and energy inflation is no longer subsiding after commodity prices have been range-bound for more than a year now. Excluding food and energy, the deflationary impulse to goods price stemming from healed supply chains and rebalanced demand has mostly petered out. This mild reflation in core goods prices has offset the gradual, ongoing slowdown in core services inflation that has taken place in recent months.

New challenges to further disinflation have emerged with the prospect of higher tariffs, lower taxes, and tighter immigration policy slowing labor force growth. However, some sources of downward pressure on price growth remain in place, including a cooling labor market and a pickup in productivity growth. We expect inflation to remain stuck near its current pace in 2025 as a result of these crosscurrents, but we do not anticipate a re-acceleration. Our latest forecast looks for core CPI to increase 3.0% on a Q4/Q4 basis in 2025, only modestly below today's reading of 3.3%.

The Fed's preferred inflation measure, the PCE deflator, typically runs 30-40 bps below the consumer price index. Accordingly, we look for the core PCE deflator to rise 2.6% Q4/Q4 in 2025. In our view, this leaves the FOMC in a position where it will continue to strive to move monetary policy towards a more neutral stance, but at a gradual and measured pace. We look for 100 bps of rate cuts from the FOMC over the next 12 months, with 25 bps rate cuts at next week's FOMC meeting and the March, June and September meetings next year. That said, the significant economic policy uncertainty driven by the change in Congress and the presidency likely will require the FOMC to be flexible in its reaction function in 2025. For further reading on the policy outlook and our 2025 expectations more generally, see our recently published annual economic outlook.

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