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# Hot January CPI Sends a Chill Over the Inflation Outlook

Economist(s)

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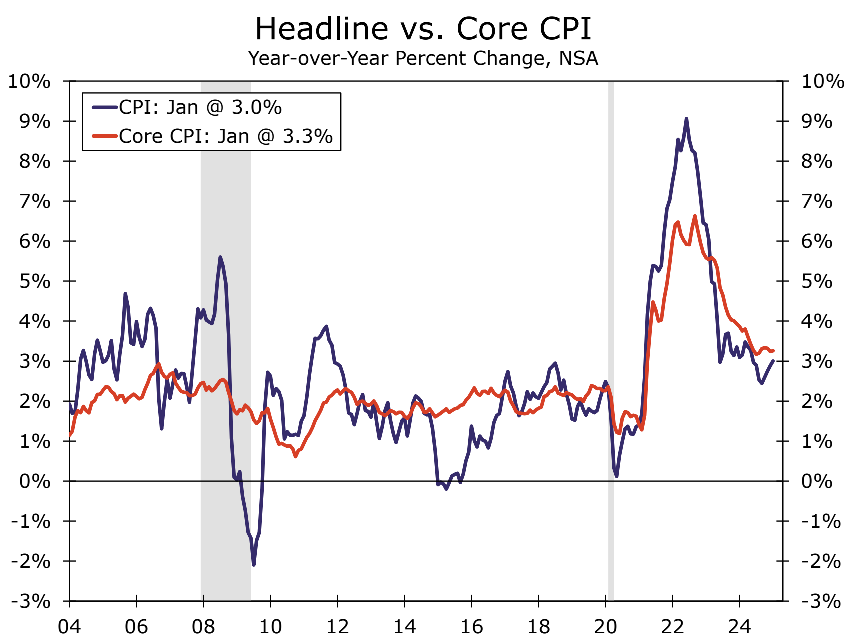
## Summary

Expectations of seeing further modest improvement in inflation at the start of this year were dashed by the January Consumer Price Index. The headline CPI rose 0.5% last month, well ahead of consensus expectations for a 0.3% increase. The upside surprise to the core index was more modest (0.4% versus expectations for a 0.3% increase), but illustrated broad-based strength in pricing at the start of the year. Core goods prices rose 0.3% and are now little changed over the past year as the deflationary tailwinds of improving supply chains have petered out. Core services prices rose 0.5% amid a 0.4% rise in shelter costs and strength in non-housing services like transportation and recreation.

The upside surprise is reminiscent of last January's CPI report and suggests even the updated seasonal factors released in today's report are still struggling to capture early year price increases after the pandemic-period scrambled the typical calendar year pattern of price changes. That said, both the year-over-year rates of the headline and core CPI indices rose over the month. Therefore, setting aside any issues over residual seasonality, today's report offers more evidence of progress in lowering inflation stalling out.

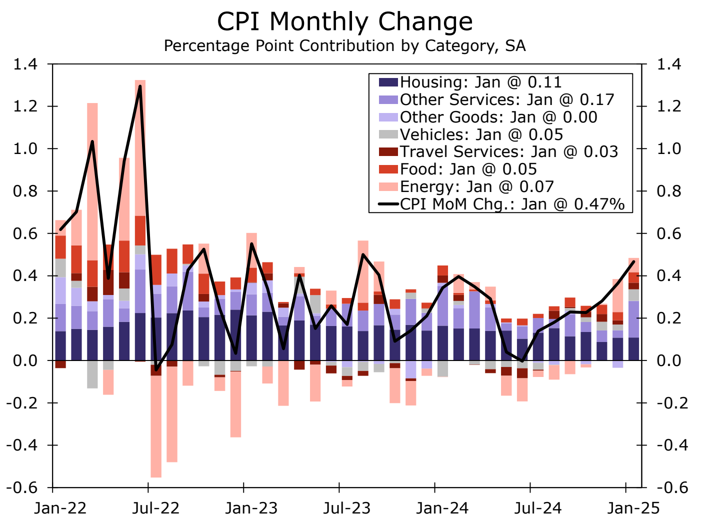



Source: U.S Department of Labor and Wells Fargo Economics

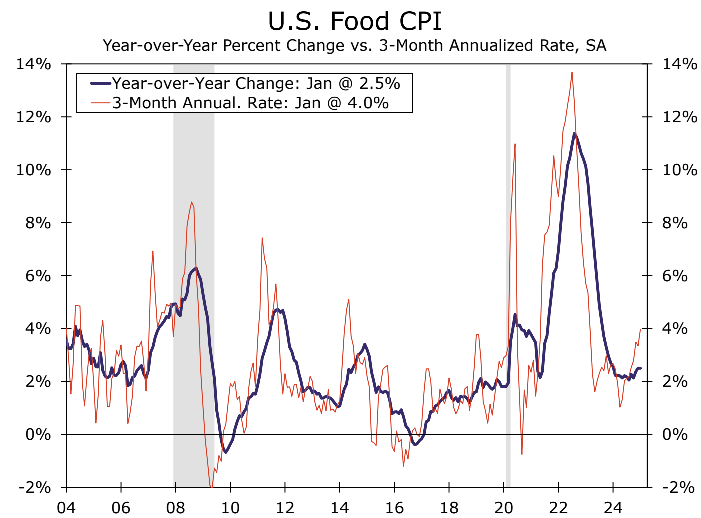
## January Déjà Vu

The stubborn picture of inflation continued in January with the Consumer Price Index coming in hotter than expected. Prices rose 0.5% at the start of the year, compared to consensus expectations of a 0.3% gain. On a year-over-year basis, prices rose 3.0%—the strongest 12-month change since June (chart).

Part of the headline's strength can be tied to a surprisingly large lift in energy prices (chart). Energy goods prices rose 1.9% amid strength in gasoline prices and fuel oil, overshadowing a more temperate rise in energy services. Meantime, the upswing in food inflation continued in January (chart). Grocery prices rose 0.5% amid another leap in egg prices (+15.2%) and are up 1.9% over the past year. Prices for food away from home rose a more modest 0.2% but continue to see more firm growth on trend having advanced 3.4% over the past year.




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

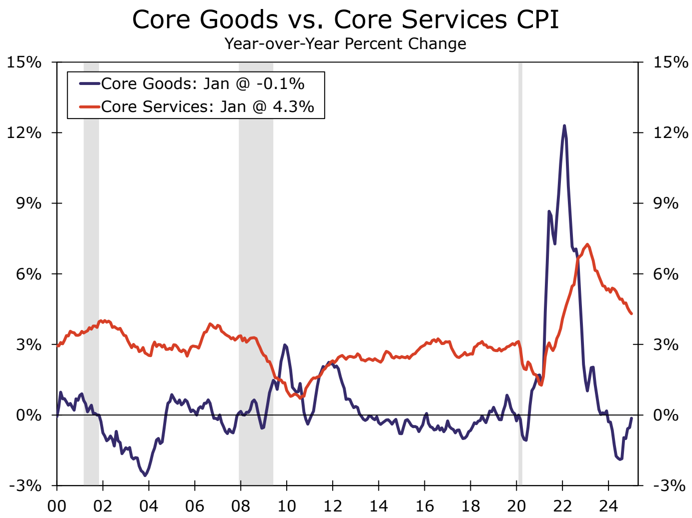



Source: U.S. Department of Labor and Wells Fargo Economics

Excluding food and energy, price growth also beat expectations with a 0.4% gain in January. Gains were broad-based among major components. Core goods prices were up 0.3% over the month and roughly flat over the past year as the disinflationary tailwinds from improved supply chains have run their course (chart). Much of the pickup can be traced to a jump in used vehicle prices (+2.2%), motor vehicle parts (+0.8%) and medical care commodities (+1.2%), whereas apparel posted a notable decline in prices (-1.4%).

On the services side, core prices rose 0.5%. The closely-watched shelter component rose 0.4% over the month, with both rent of primary residences and owners' equivalent rents rising 0.3%, in line with their six-month averages. Lodging away from home, however, helped lift the shelter component with a +1.4% rise over the month, which we see as partially tied to the L.A. wildfires given higher-than-usual occupancy in the area during the month. Beyond shelter, outsized gains in motor vehicle insurance (+2.0%), airline fares (+1.2) and recreation services helped drive core services higher.

January's unexpected strength echoes the pop in prices registered at the start of 2024 and renews questions over residual seasonality (i.e., the inability of seasonal factors to fully capture regular calendar patterns) in the data. However, looking at the year-over-year data to remove issues around seasonality also points to inflation's ongoing strength. The 12-month pace of core CPI picked up to 3.3% in January, keeping it within the 3.2%-3.3% range it has resided in since June (chart). We expect the 12-month rate of core inflation to remain stuck near this level in the coming months, with the core index rising at a loftier 3.8% annualized pace over the past three months.

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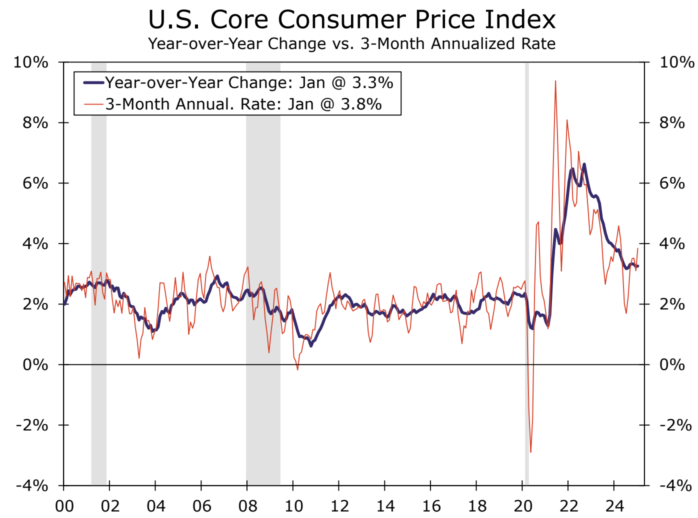


Source: U.S. Department of Labor and Wells Fargo Economics

FOMC officials have made clear that they are in no hurry to adjust the current stance of monetary policy. With inflation still running above the FOMC's target, the labor market looking sturdier after last summer's wobble and heightened uncertainty around economic policy changes, we believe the Committee has settled into a prolonged hold. We have not changed our expectations for two 25 bps rate cuts in September and December of this year, but we believe the risks are skewed toward no cuts this year if the inflation data do not cool further in the months ahead.

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