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Economics Group

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CPI Jumps in January, but Trend Looks More Moderate

Consumer prices rose 0.6 percent to start the year. While broad gains in the core index suggest inflation continues to strengthen, January's gain looks a bit overstated given the jump in gasoline and core goods.

Inflation Starts the Year Strong

Inflation picked up at the start of the year, with the Consumer Price Index (CPI) rising a stronger-than-expected 0.6 percent. While much of the lift was provided by energy (gasoline prices were up 7.8 percent), prices picked up across a broad range of components.

Food prices continue to see little traction (up 0.1 percent last month), but once again the headline masks the divergent trends in prices for food bought at the grocery store and prices for eating out. Prices for food at home were unchanged last month, while prices for food away from home jumped 0.4 percent last month. The strong increase for food away from home may reflect some pass-through of rising wage costs as another wave of states and large cities raised the minimum wage at the start of the year.

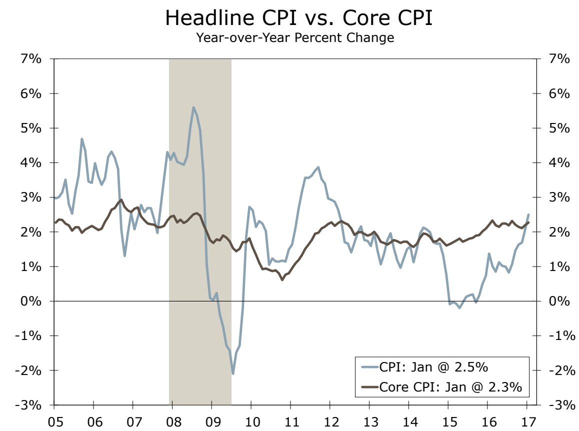
While yesterday's strong gain in the PPI looked to suffer from some residual seasonality (i.e., the seasonal adjustment process did not fully account for price hikes at the start of the year), today's increase in the CPI looks fairly genuine. The BLS updated its seasonal factors earlier this week, and the average gain over the past six Januarys are right in line with changes during other months of the year.

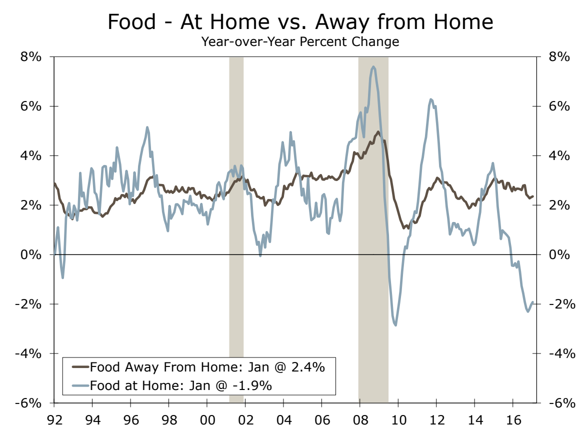
One exception to this is in the core goods component. Core goods prices, which account for about 20 percent of CPI, were up 0.4 percent in January, a month that has seen noticeably stronger gains than the rest of the year since 2010. Apparel prices jumped 1.4 percent as retailers moved away from holiday discounting. Prices for new vehicles also posted a sizeable increase, up 0.9 percent.

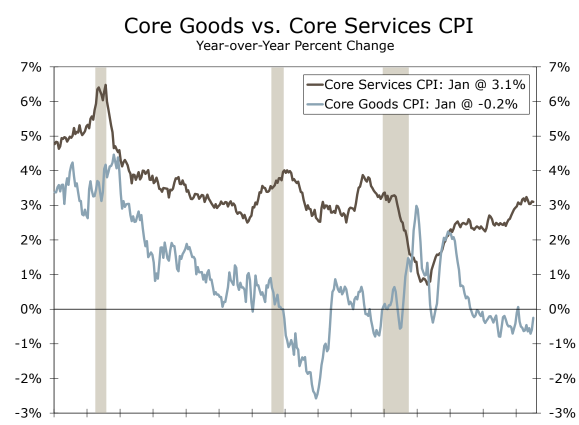
All told, the increase in core goods prices was the largest since late 2009. While this hints that the deflationary pressure from this part of the CPI is fading, last year Fed Chair Janet Yellen was skeptical of a similarly strong rise in core inflation at the start of the year given that it was coming from some of the more volatile components (the goods sector) of the core index. The trend in core services remains fairly steady. Prices rose 0.3 percent last month and are running a little over 3 percent the past year.

Not Hot Enough for the Fed

Today's move fits with Fed Chair Yellen's view that inflation is gradually rising. The modest upward trend in core prices leaves the Fed scope to slowly move the fed funds rate higher this year, particularly as the most recent reads on unemployment and labor force participation suggest at least modest amounts of slack remain in the labor market. The Fed's preferred measure on inflation, the PCE deflator, has turned up in recent months following the rebound in oil, but the core PCE remains below the FOMC's 2 percent target. Therefore, we continue to expect the Fed's next rate increase to come at its June meeting.







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

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