



Economics Group

Sarah House, Economist
sarah.house@wellsfargo.com • (704) 410-3282

December CPI Rises on Gasoline and Broad Gains in the Core

Consumer price inflation rose 0.3 percent in December on an increase in gasoline prices but also a solid 0.2 percent rise in core inflation. Inflation pressures are building, but not fast enough to alarm the Fed.

Energy Recovery Brings CPI Back Above 2 Percent

Coming in line with expectations, CPI inflation rose 0.3 percent in December. Headline CPI is now running above 2 percent for the first time since mid-2014, when the 2014-2016 collapse in oil prices began. As expected, gasoline prices were a major driver of December's increase, rising 3.0 percent. Lower natural gas prices and steady electricity prices, however, tempered the overall gain in energy costs.

Food prices were unchanged for a sixth straight month, but the flat headline continues to mask the divergent trends in prices for food bought for at-home consumption and eating out. Prices for food at home are down 2.0 percent over the past year amid declines across all major grocery categories, most notably a 5.4 percent drop in prices for meats, poultry & eggs. Prices for food away from home, on the other hand, continue to rise, but the pace has moderated in recent months.

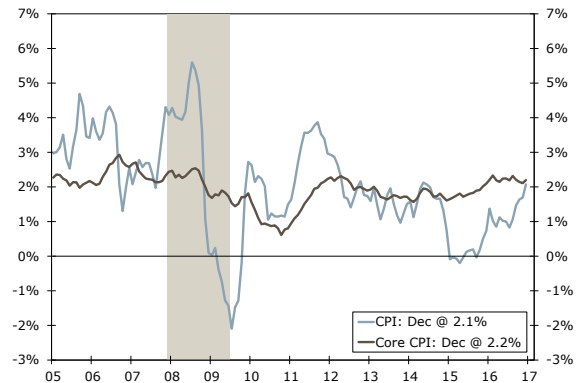
Outside of food and energy, prices continue to gradually increase. The core index rose 0.2 percent last month, bringing the year-over-year rate back up to 2.2 percent. Gains were fairly widespread, but once again were driven by the service sector. Core services inflation rose 0.3 percent in December on a rise in shelter costs of the same magnitude. Transportation services also provided a notable boost, increasing 0.6 percent on higher costs for motor vehicle insurance and airline fares. Out-of-pocket costs for medical care services edged up 0.1 percent last month and 3.9 percent over the past year. Pricing power in the goods sector remains more limited, but showed some improvement in December. Core goods prices were flat last month after declining 0.6 percent over the past year. A 0.7 percent drop in apparel prices offset gains in vehicle prices, medical goods, alcohol and tobacco.

Gradual Gains in Core Inflation on the Horizon

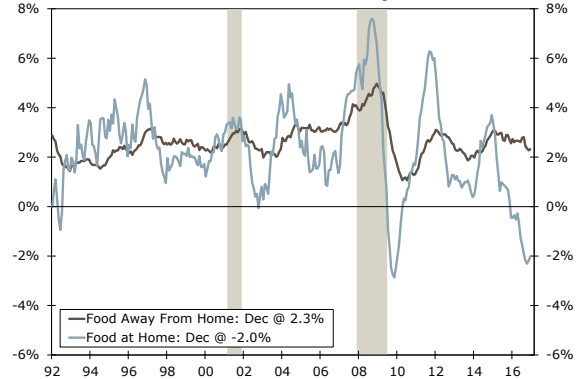
Despite only temperate gains in core inflation over the past few months, we expect strengthening in the year ahead. Unit labor costs are rising as average hourly earnings, up 2.9 percent over the past year, are increasing at the fastest pace of the expansion and productivity growth remains tepid. As the labor market continues to tighten, we expect businesses, particularly in the labor-intensive service sector, to pass on a greater share of cost increases and generate higher inflation.

The pickup in core CPI, however, should remain fairly gradual and should not incite FOMC officials to ratchet up the pace of tightening currently outlined. The more closely watched core PCE deflator remains below 2 percent and, while also anticipated to rise this year, is not expected to breach the Fed's target until early next year. With consumer inflation expectations struggling to rebound and market based measures of inflation compensation still low relative to a few years ago, the Fed will likely remain cautious on the inflation front.

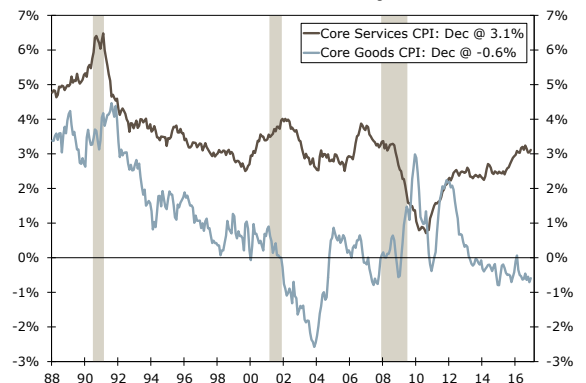
Headline CPI vs. Core CPI
 Year-over-Year Percent Change



Food - At Home vs. Away from Home
 Year-over-Year Percent Change



Core Goods vs. Core Services CPI
 Year-over-Year Percent Change



Wells Fargo Securities Economics Group

Diane Schumaker-Krieg	Global Head of Research, Economics & Strategy	(704) 410-1801 (212) 214-5070	diane.schumaker@wellsfargo.com
John E. Silvia, Ph.D.	Chief Economist	(704) 410-3275	john.silvia@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Jay H. Bryson, Ph.D.	Global Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Currency Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Anika R. Khan	Senior Economist	(212) 214-8543	anika.khan@wellsfargo.com
Eugenio J. Alemán, Ph.D.	Senior Economist	(704) 410-3273	eugenio.j.aleman@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 410-3270	azhar.iqbal@wellsfargo.com
Tim Quinlan	Senior Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Eric Viloría, CFA	Currency Strategist	(212) 214-5637	eric.viloria@wellsfargo.com
Sarah House	Economist	(704) 410-3282	sarah.house@wellsfargo.com
Michael A. Brown	Economist	(704) 410-3278	michael.a.brown@wellsfargo.com
Jamie Feik	Economist	(704) 410-3291	jamie.feik@wellsfargo.com
Erik Nelson	Currency Analyst	(212) 214-5652	erik.f.nelson@wellsfargo.com
Misa Batcheller	Economic Analyst	(704) 410-3060	misa.n.batcheller@wellsfargo.com
Michael Pugliese	Economic Analyst	(704) 410-3156	michael.d.pugliese@wellsfargo.com
Julianne Causey	Economic Analyst	(704) 410-3281	julianne.causey@wellsfargo.com
E. Harry Pershing	Economic Analyst	(704) 410-3034	edward.h.pershing@wellsfargo.com
Donna LaFleur	Executive Assistant	(704) 410-3279	donna.lafleur@wellsfargo.com
Dawne Howes	Administrative Assistant	(704) 410-3272	dawne.howes@wellsfargo.com

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