



Economics Group

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CPI: Beyond the Headline, Inflation Strengthening

Consumer price inflation edged up 0.1 percent in December despite a fall in gasoline prices. Reversing last month's weakness, core inflation rose 0.3 percent and is up at a 2.5 percent pace over the past three months.

Gasoline Savings Going Elsewhere

Inflation cooled in December with the Consumer Price Index (CPI) increasing 0.1 percent. That followed a 0.4 percent gain in November. The tamer increase stemmed from a pullback in energy costs as gasoline prices fell 2.7 percent over the month. That overshadowed a modest rise in energy services (electricity and utility gas). It was not until late in the month that unusually low temperatures led to a jump in natural gas prices. Although not quite halfway through the month, spot prices for natural gas are up about 6 percent from their December average. Therefore, we suspect energy services could provide an even larger lift to headline inflation next month.

For December, food prices rose 0.2 percent. That marks the largest increase since July and suggests that more stable prices for food commodities and rising labor costs for food services workers may be reasserting some modest upward pressure on the sector.

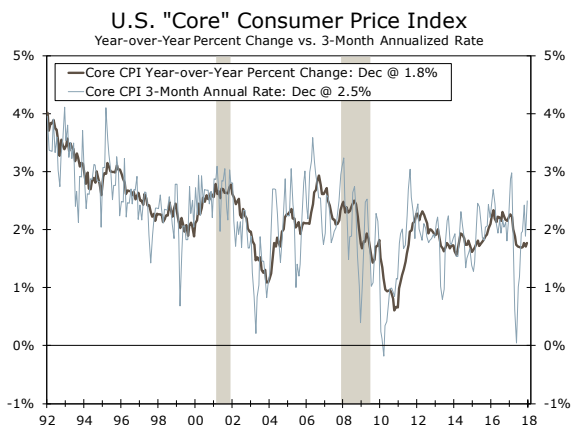
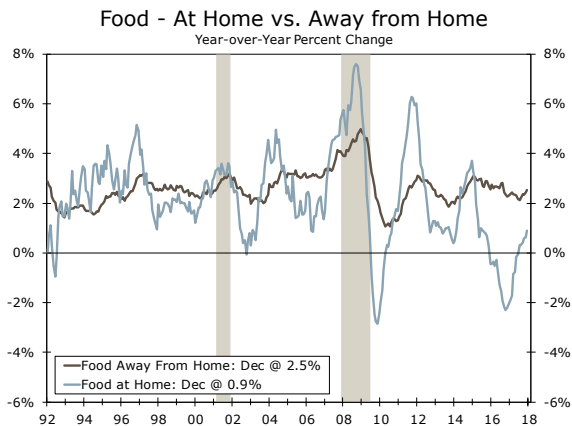
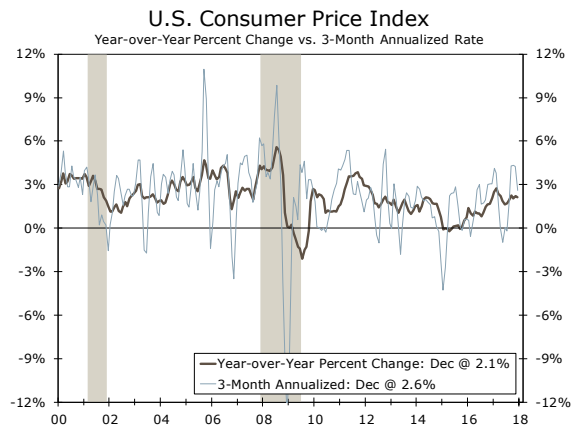
Core Inflation Rebounds

Core inflation bounced back after a weaker-than-expected reading in November. Excluding food and energy, prices were up 0.3 percent. Core goods prices posted a rare increase and moved 0.2 percent higher. Leaner auto inventories after last year's natural disasters spurred demand to replace vehicles and slower production growth more generally has given some support to prices. After falling from February to September, new and used vehicle prices have risen the past three months, including the largest monthly gain in December in more than six years. A 1.0 percent jump in prescription drug prices also pushed core goods inflation higher.

Stronger core inflation was also driven by services. Shelter costs advanced an above-trend 0.4 percent in December. Rent of primary residences and owned residence both rose more than in November, while lodging costs partially reversed last month's drop. Costs for medical care services also rebounded after a sharp decline in physician services in November.

Getting Back to the Fed's Target

Inflation has been the darkest cloud hanging over the Fed's efforts to normalize policy. Over the past year, inflation has risen 2.1 percent, a touch lower than November's 12-month change and noticeably below the pace set earlier in the year. Yet the recent trend looks stronger. Over the past three months headline inflation is up at a 2.6 percent annualized pace. Similarly, core inflation, which is up 1.8 percent on a year-ago basis, has risen at a 2.5 percent pace over the past three months. This should help to allay some FOMC members' fears that inflation is stuck at undesirably low levels. We expect to see a noticeable pick up in the year-over-year change by this spring. Although that will stem in large part from base effects following weakness last year, the trend remains upward.



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