Special Commentary — April 3, 2024

March CPI Preview: Early-Year Strength in Inflation Noise or Signal?

Economist(s)

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Summary

The March CPI report will be a key indication of whether the pickup in inflation at the start of 2024 was a function of early-year noise or if inflation's journey back to the Fed's target has been drawn out materially. We believe it will show hints of both dynamics at play. Headline CPI likely rose by 0.4% for a second straight month, which would push the year-over-year rate up to a six-month high of 3.5%. Excluding food and energy, we estimate prices rose 0.3%—a tick softer than in January and February but similar to the pace averaged in Q4, in a sign underlying progress remains stubbornly slow. We suspect core goods fell back into deflation territory in March. Core services inflation, however, was likely little changed as a further moderation in shelter costs was offset by a pickup in services ex-housing.

Looking beyond March, we expect inflation to move lower this year. However, progress will be more of a grind ahead. A rebound in commodity costs have turned food and energy from tailwinds to headwinds. Meantime, supply chain strains are no longer easing. While we believe core goods prices have some additional room to fall over the next few months as earlier benefits of supply chain normalization feed through to prices, services prices will need to cool more markedly to keep overall inflation on its downward path. We expect to see a further moderation in shelter costs help drive the year-over-year rate of core CPI down from 3.8% at present to 3.3% in Q4, although progress is likely to be harder to discern when measured by the PCE deflator, the Fed's preferred inflation gauge.

March 2024 Forecast

	Wells Fargo Economics			Consensus	
Seasonally Adjusted	**MoM (%)**	**3-M Ann. (%)**	**YoY (%)**	**MoM (%)**	**YoY (%)**
CPI	0.38	4.6	3.5	0.4	3.4
Food	0.24	2.6	2.4	-	-
Energy	1.30	11.0	2.3	-	-
Core CPI	0.33	4.4	3.8	0.3	3.7
Goods	-0.06	-1.1	-0.6	-	-
Services	0.45	6.4	5.3	-	-
Services ex. Shelter*	0.51	7.2	4.6	-	-
Not Seasonally Adjusted	**Index**	**MoM (%)**	**YoY (%)**	**Index**	**MoM (%)**
CPI	312.332	0.6	3.5	-	-

Forecast as of: April 03, 2024; Bloomberg Consensus
*Core services CPI excluding rent of primary residence and owners' equivalent rent

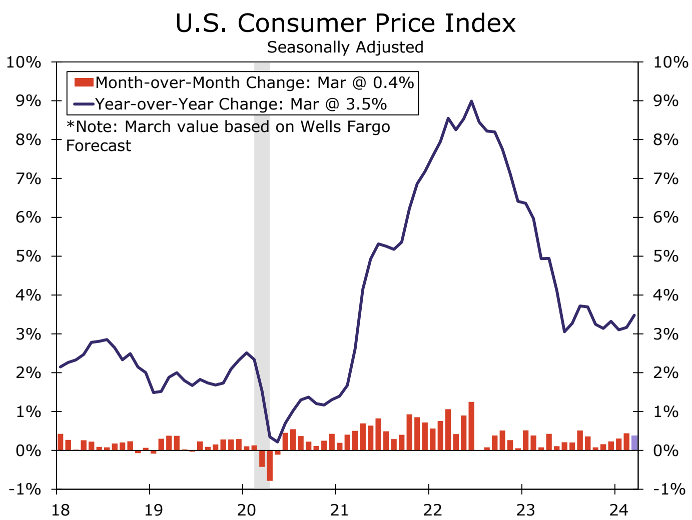
Source: U.S. Department of Labor, Bloomberg Finance L.P. and Wells Fargo Economics

March CPI: Stalled Progress on Headline but Slight Progress on Core

The March Consumer Price Index should be telling of whether the pickup in inflation in January and February was a function of early-year noise or if inflation's journey back to the Fed's target has been drawn out materially. We expect headline CPI to show that progress in slowing overall price growth has at least temporarily gone into reverse. We estimate the CPI rose 0.4% for a second consecutive month, which is currently in line with the Bloomberg consensus estimate. If realized, the 12-month rate of CPI would move back up to a six-month high of 3.5% (Figure 1).

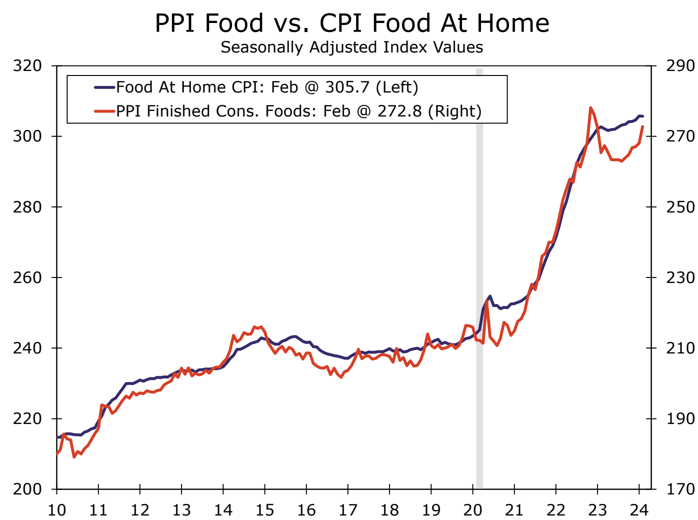
Similar to February, March's headline strength will be partly attributable to higher gasoline prices. Prices at the pump rose a little faster than usual for this time of year, which by our estimates will translate into a 2.5% seasonally-adjusted increase in energy commodities. Food inflation is also likely to be stronger in March. The Producer Price Index (PPI) for finished consumer goods picked up sharply in February, pointing to firmer prices in the CPI's food at home index (Figure 2). Meantime, price growth in the food away from home segment looks ripe for some mean-reversion after the index in February posted the smallest monthly gain in three years.

Figure 1



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

Figure 2



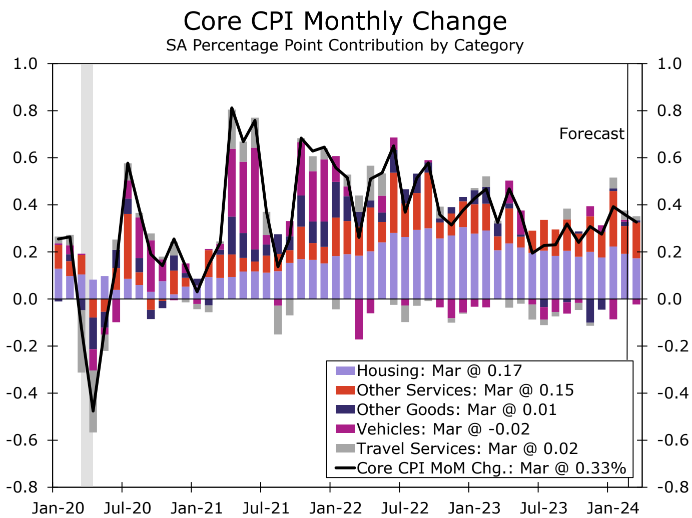
Source: U.S Department of Labor and Wells Fargo Economics

The core CPI is likely to show that progress in lowering inflation remains ongoing, albeit at a frustratingly slow pace. After rising 0.4% in both January and February, we estimate prices excluding food and energy advanced 0.3% in March. Core goods prices are likely to have fallen back to deflation territory following a 0.1% rise in February. We look for the pullback to be driven by a renewed decline in used vehicle prices (-0.8%) and a further modest drop in new vehicle prices (-0.1%). Price growth among other goods is likely to be little changed (Figure 3).

Housing inflation likely continued its gradual downward trend in March.

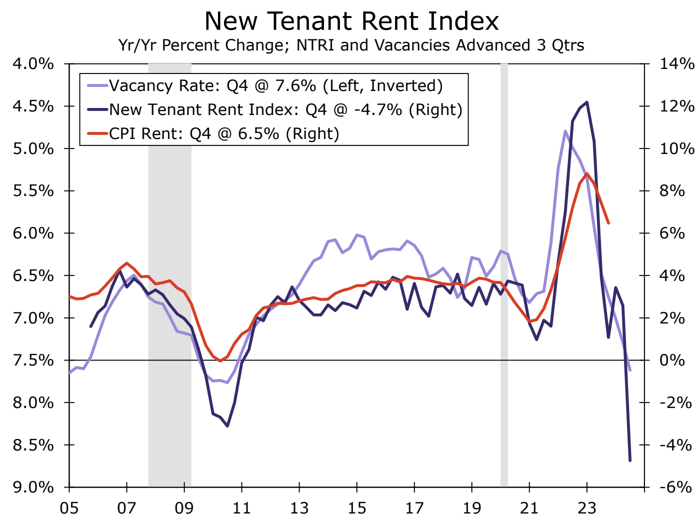
Core services inflation looks to have been steady in March at around a 0.4-0.5% monthly increase, although that would still be a step down from January's worrisome rise of 0.7%. Housing inflation likely continued its gradual downward trend. After popping back up in February, rent of primary residences likely slowed in March. In addition to apartment vacancies climbing and private sector measures of "spot" rental rates having subsided sharply, the U.S. Department of Labor's New Tenant Rent Index (NTRI) shows a steep slowdown for renters changing housing units (Figure 4). The moderating trend in rental rates should also help to keep a lid on owners' equivalent rent growth; we look for another 0.4% rise in this component in March after it turned heads in January with a 0.6% increase.

Figure 3



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

Figure 4



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

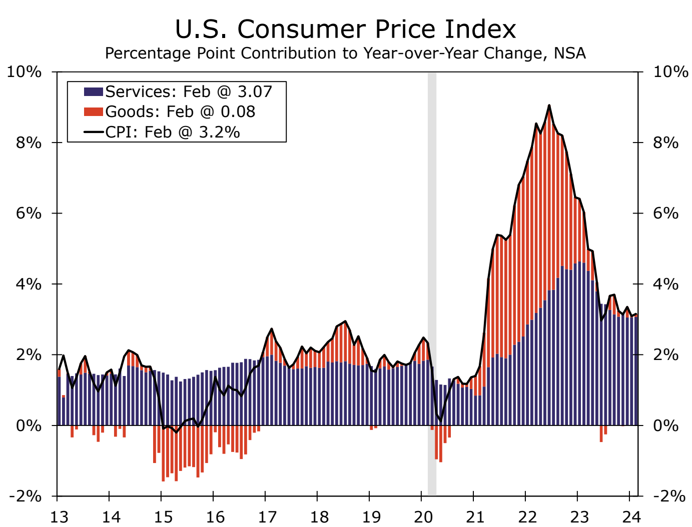
Excluding housing, core services inflation likely picked up in March. We estimate the CPI equivalent of "super-core" inflation rose 0.5% last month, led by rebounds in medical care, motor vehicle insurance and personal care services. That would keep the 3-month annualized rate of super-core CPI at 7.2% and suggests the PCE super-core picked up from a monthly gain of 0.2% in February to 0.3-0.4% in March.

Outlook: Services Need to Run with the Disinflation Baton

We expect inflation to move lower throughout the year, but progress will be more of a grind ahead. Slower growth in goods prices has accounted for half of the decline in CPI inflation over the past year (Figure 5). Recent gains in oil prices and agricultural commodities, however, are turning energy and food from a significant tailwind to disinflation over the past year and a half to at least a modest headwind ahead. We have raised our forecast for prices of energy commodities, although the risk of additional near-term adjustments lie to the upside given the recent momentum of oil prices. Meantime, supply chain strains are no longer easing. Even before the latest logistical challenges stemming from the conflict in the Red Sea or collapse of the Key Bridge in Baltimore, supply chain pressures according to the New York Fed's barometer had returned to a roughly neutral stance.

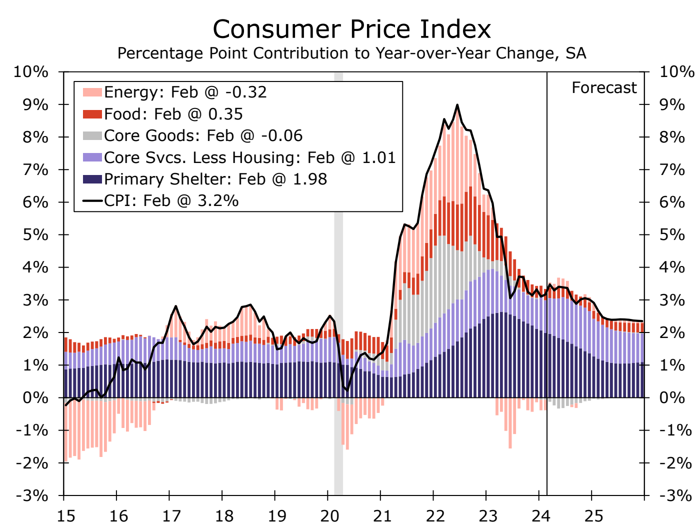
We expect inflation to move lower throughout the year, but progress will be more of a grind ahead.

Figure 5



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

Figure 6



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

We believe core goods prices have some further room to fall over the next six months or so as the earlier benefits of supply chain normalization feed through to prices. However, ongoing declines will depend increasingly on demand giving way as supply tailwinds fade. Motor vehicle prices in particular are likely to remain under pressure and to generate the bulk of goods disinflation in coming months as inventories continue to realign with sales and consumers contend with decades' high financing costs.

With goods disinflation petering out later this year, services prices will need to slow further to keep inflation on its downward path. Shelter inflation still looks poised to lead the charge. Although monthly readings of primary shelter have been stuck around 0.4-0.5% since last spring, the steep decline in "spot" rents implies a step down to 0.2-0.4% through the rest of the year. We expect primary shelter to slow from a 5.9% year-over-year rate in February to 4.0% in December, which would reduce its contribution to headline CPI by 0.6 points and help to narrow the unusually large wedge between CPI and PCE inflation. Prices for motor vehicle related services, including insurance, should also ease with auto prices having come off their pandemic highs. Downward pressure on wages as the labor market has cooled and fewer workers are quitting their jobs should further temper the monthly pace of core services ex-housing inflation. We estimate the CPI super-core will increase at a 4.3% annualized rate in Q4 compared to 7.1% this past quarter.

With goods disinflation petering out over the course of this year, services prices will need to slow further to keep inflation on its downward path.

While core CPI inflation is still on track to push lower this year, progress in the fight against inflation will be harder to discern from the PCE deflator (Figure 7). The disinflationary impulse from housing will not go as far in the PCE measure of inflation given shelter's significantly smaller weight. In addition, the sharp slowdown in the monthly rate of core PCE inflation in the second half of last year will create tough base comparisons, leaving the year-over-year rate stuck around 2.5-2.7% until next January by our estimates. That said, we expect the three-month annualized rate of core PCE to slip to 2.5% by June and continue to moderate over the second half of the year. With the labor market close to balanced, we think that will likely be enough for the Fed to proceed with at least some easing this year.

Figure 7

Wells Fargo U.S. Inflation Forecast

	Actual				Forecast							
	2023				2024				2025			
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
CPI (YoY)	5.7	4.0	3.6	3.2	3.3	3.4	3.1	3.0	2.7	2.4	2.4	2.4
QoQ Annualized	3.8	3.0	3.4	2.7	3.8	3.5	2.4	2.5	2.4	2.4	2.4	2.3
Core CPI (YoY)	5.5	5.2	4.4	4.0	3.8	3.5	3.5	3.3	2.9	2.7	2.6	2.5
QoQ Annualized	4.9	4.7	3.0	3.4	4.2	3.6	2.9	2.6	2.6	2.6	2.6	2.5
PCE Deflator (YoY)	5.0	3.9	3.3	2.8	2.5	2.5	2.4	2.4	2.2	2.1	2.1	2.1
QoQ Annualized	4.2	2.5	2.6	1.8	3.0	2.8	1.9	2.0	2.2	2.2	2.1	2.0
Core PCE Deflator (YoY)	4.8	4.6	3.8	3.2	2.8	2.5	2.6	2.6	2.4	2.3	2.2	2.3
QoQ Annualized	5.0	3.7	2.0	2.1	3.3	2.7	2.2	2.1	2.3	2.3	2.2	2.1

Forecast as of: April 3, 2024
Note: All numbers are percent change.

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

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