



Economics Group

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

Food and Fuel Drive CPI Higher, but Core Inflation Tepid

The CPI rose 0.4% in December, largely due to higher gasoline and food prices. Core inflation, however, was more subdued (+0.1%) and suggests that the widely-expected pickup in inflation remains some months away.

Strengthening in Inflation Is Spotty

Consumer price inflation picked up in December with the CPI increasing 0.4%. That followed a 0.2% rise in November and was driven largely by higher gas prices (+8.4%) and higher food prices at grocery stores and restaurants (both up +0.4%). Core inflation, however, slowed in December and underscores that on its own, the pandemic is a disinflationary event.

Excluding food and energy, prices were up just 0.1%. Core goods inflation picked up slightly (+0.2%), as stronger gains in apparel and new vehicles more than offset declining prices for used autos and prescription drugs. But services inflation remains bogged down by tepid increases in housing costs. The disproportionate toll of job losses in low-pay industries continues to weigh on the rental market. The design of the CPI survey means it will be months before the jump in home prices feeds into the largest CPI component, owners' equivalent rent. Meanwhile, with the pandemic intensifying, the rebound in travel-related costs paused, with hotel prices unchanged and airfares declining 2.3%. Costs for medical services declined for a fourth consecutive month despite higher prices for hospital care.

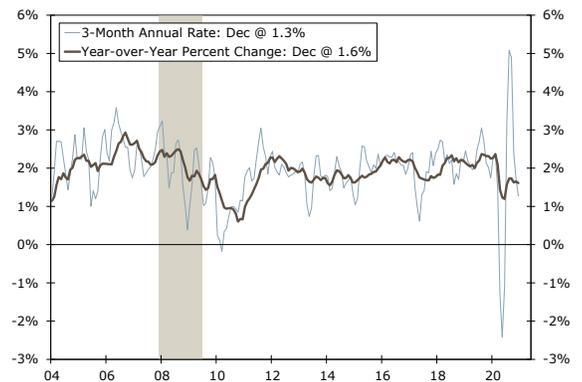
Firmer Inflation this Year, But Not Off to the Races

On a year-ago basis, CPI inflation moved up in December but remains weak at 1.4%. The 12-month change in the CPI is set to pop in the spring, however, reaching roughly 3% in May after prices collapsed last year during initial lockdowns for categories like gasoline, hotels, and apparel. But the easy base comparisons will overstate the degree of price pressures we expect this year.

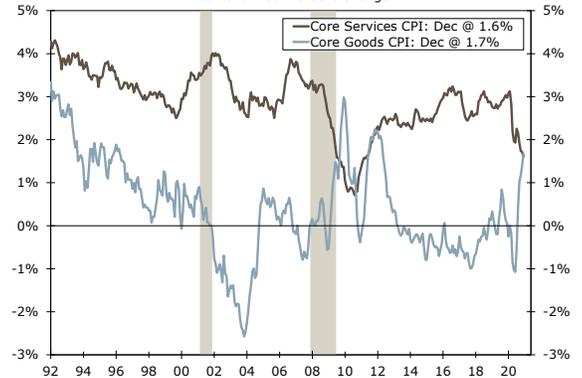
We anticipate inflation to firm over 2021 as consumer spending roars back in the second half of the year, but do not expect inflation will be off to the races. Core goods inflation over the past year has increased at the strongest pace since 2012, as more time at home and the avoidance of public transportation have sent prices for things like home goods and cars sharply higher. Yet as supply bottlenecks ease and consumers shift spending back toward experiences, we expect goods inflation to slow and water down the effect of stronger inflation in discretionary services on core CPI.

The Fed likely will not be spooked by the year-over-year pop in inflation this spring. Inflation is a process, driven by ongoing price changes rather than one-off adjustments in reaction to specific events. Instead, the FOMC will be focused on signs that the strengthening in inflation will be durable. Inflation expectations will play a crucial role in that assessment. Market measures of inflation expectations have been rising, but consumer measures remain near historic lows. That could change in the second half of the year when realized inflation is higher, but we suspect it will be some time before inflation returns to a pace consistent with the Fed's target and the FOMC is confident it can stay there.

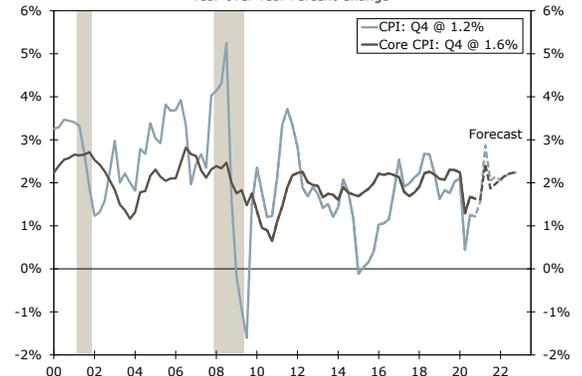
Core CPI Inflation



U.S. Core CPI - Services vs. Goods



Consumer Price Index



Wells Fargo Securities Economics Group

Jay H. Bryson, Ph.D.	Chief Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	International Economist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Azhar Iqbal	Econometrician	(212) 214-2029	azhar.iqbal@wellsfargo.com
Sarah House	Senior Economist	(704) 410-3282	sarah.house@wellsfargo.com
Charlie Dougherty	Economist	(704) 410-6542	charles.dougherty@wellsfargo.com
Michael Pugliese	Economist	(212) 214-5058	michael.d.pugliese@wellsfargo.com
Brendan McKenna	International Economist	(212) 214-5637	brendan.mckenna@wellsfargo.com
Shannon Seery	Economist	(704) 410-1681	shannon.seery@wellsfargo.com
Jen Licis	Economic Analyst	(704) 410-1309	jennifer.licis@wellsfargo.com
Hop Mathews	Economic Analyst	(704) 383-5312	hop.mathews@wellsfargo.com
Nicole Cervi	Economic Analyst	(704) 410-3059	nicole.cervi@wellsfargo.com
Sara Cotsakis	Economic Analyst	(704) 410-1437	sara.cotsakis@wellsfargo.com
Coren Burton	Administrative Assistant	(704) 410-6010	coren.burton@wellsfargo.com

Wells Fargo Securities Economics Group publications are produced by Wells Fargo Securities, LLC, a U.S. broker-dealer registered with the U.S. Securities and Exchange Commission, the Financial Industry Regulatory Authority, and the Securities Investor Protection Corp. Wells Fargo Securities, LLC, distributes these publications directly and through subsidiaries including, but not limited to, Wells Fargo & Company, Wells Fargo Bank N.A., Wells Fargo Clearing Services, LLC, Wells Fargo Securities International Limited, Wells Fargo Securities Canada, Ltd., Wells Fargo Securities Asia Limited and Wells Fargo Securities (Japan) Co. Limited. Wells Fargo Securities, LLC is registered with the Commodities Futures Trading Commission as a futures commission merchant and is a member in good standing of the National Futures Association. Wells Fargo Bank, N.A. is registered with the Commodities Futures Trading Commission as a swap dealer and is a member in good standing of the National Futures Association. Wells Fargo Securities, LLC and Wells Fargo Bank, N.A. are generally engaged in the trading of futures and derivative products, any of which may be discussed within this publication. Wells Fargo Securities, LLC does not compensate its research analysts based on specific investment banking transactions. Wells Fargo Securities, LLC's research analysts receive compensation that is based upon and impacted by the overall profitability and revenue of the firm which includes, but is not limited to investment banking revenue. The information and opinions herein are for general information use only. Wells Fargo Securities, LLC does not guarantee their accuracy or completeness, nor does Wells Fargo Securities, LLC assume any liability for any loss that may result from the reliance by any person upon any such information or opinions. Such information and opinions are subject to change without notice, are for general information only and are not intended as an offer or solicitation with respect to the purchase or sales of any security or as personalized investment advice. Wells Fargo Securities, LLC is a separate legal entity and distinct from affiliated banks and is a wholly owned subsidiary of Wells Fargo & Company © 2021 Wells Fargo Securities, LLC.

Important Information for Non-U.S. Recipients

For recipients in the EEA, this report is distributed by Wells Fargo Securities International Limited ("WFSIL"). WFSIL is a U.K. incorporated investment firm authorized and regulated by the Financial Conduct Authority. For the purposes of Section 21 of the UK Financial Services and Markets Act 2000 ("the Act"), the content of this report has been approved by WFSIL, an authorized person under the Act. WFSIL does not deal with retail clients as defined in the Directive 2014/65/EU ("MiFID2"). The FCA rules made under the Financial Services and Markets Act 2000 for the protection of retail clients will therefore not apply, nor will the Financial Services Compensation Scheme be available. This report is not intended for, and should not be relied upon by, retail clients.

SECURITIES: NOT FDIC-INSURED/NOT BANK-GUARANTEED/MAY LOSE VALUE