



Economics Group

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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.

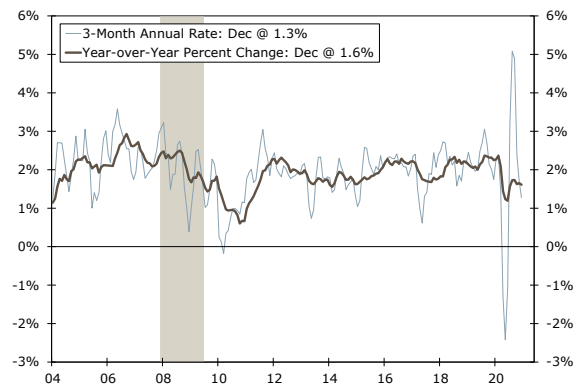
Firmer Inflation this Year, But Not Off to the Races

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.

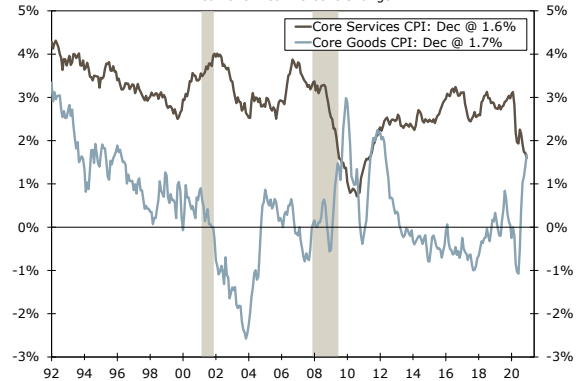
We anticipate inflation to firm over 2021 as consumer spending roars back in the second half of the year, but do not expect inflation will be off to the races. Core goods inflation over the past year has increased at the strongest pace since 2012, as more time at home and the avoidance of public transportation 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 prices 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.

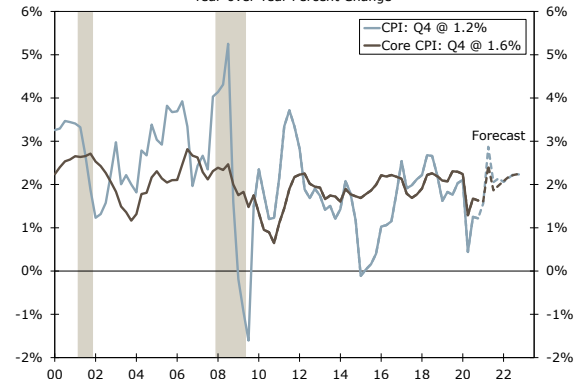
Core CPI Inflation



U.S. Core CPI - Services vs. Goods



Consumer Price Index



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