Core US CPI Leans Against 'Crosswinds'

U.S. CPI (m/m%; y/y%), December:
Actual: -0.1 / 1.9
Scotia: -0.2 / 1.9
Consensus: -0.1 / 1.9
Prior: 0.0 / 2.2 (Unrevised)

U.S. Core CPI (m/m%; y/y%), December:
Actual: 0.2 / 2.2
Scotia: 0.2 / 2.1
Consensus: 0.2 / 2.2
Prior: 0.2 / 2.2 (Unrevised)

- Resilient core CPI is the main point of emphasis here. I'm a relative rate hawk but had gone with the part of consensus that expected a slightly softer core CPI estimate this time around and that didn't transpire. Instead, core CPI didn't budge from 2.2% y/y and masks underlying breadth to the gains with some of the component increases standing out. What it means to the Fed is suggested below. Markets were little affected by the update except for a mild subsequent appreciation in the USD.
- **Headline CPI fell as expected due to a 7.5% m/m drop in gasoline prices** but also because of a combination of base effects and typical seasonality in the seasonally unadjusted month-ago core CPI figure. The latter fell 0.3% m/m which was bang in line with the average for December over the past five years.
- **Before turning to components, what does it all mean to the Fed?** Ordinarily you might think that strong job growth, accelerating wages at the fastest pace in about a decade, a tie with a two-decade low in the UR that in turn was the lowest since the late 1960s, firm core CPI that is trending toward the top end of the range of the post-GFC era, and solid GDP growth that is well above potential growth and driving the largest amount of excess aggregate demand in about two decades would keep them on track with hikes! But they've dug in on the Powell put with their 'patience', 'waiting,' 'watching' and 'flexible' mantras on what I perceive to be an erratic communications shift since December. They're putting a lot of stock on things going badly insofar as the crosswinds that Clarida emphasizes are concerned and maybe that will turn out to be worse yet. But it's a significant bet to ignore the underlying fundamentals data especially given the Fed's pattern of waiting too late to tighten enough and consequentially letting imbalances and inflation get out of hand. If we find negotiated settlements to the ides of March risks I've been flagging, then the attention turns back to the fundamentals and they keep hiking. Quickly. That's our baseline view here in our pending forecast update today.
- Across components, energy was down 3.5% m/m in line with expectations for lower gas prices to show up (again, -7.5% m/m). But fuels and utilities within the housing component jumped 1% and have been strong for three months now as electricity prices jumped. Ex-energy CPI increased 0.2% m/m.
- Housing was up 0.4% for the strongest rise since March 2014. Again, that was driven by the fuels and electricity component, but owners' equivalent rent was up 0.2% (0.3% prior).

CONTACTS

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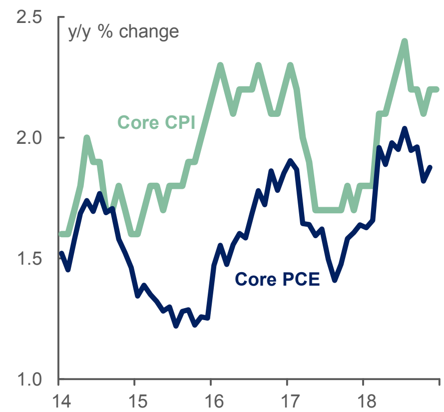
Will Core PCE Follow Core CPI Higher?



Sources: Scotiabank Economics, Bloomberg.

- Overall services prices were up 0.3% m/m for a mild acceleration.
- Food prices were up 0.4% m/m for the strongest rise since May 2014. Within food prices there was breadth to the rise. Fruits and vegetables were up 1.7% m/m for the biggest jump since April 2017 which had been the biggest rise since March 2011. Dairy prices were up 0.25% m/m which was the largest rise since June after several months of decline. Cereals/baked goods were up 0.44% for the strongest gains in three of the past four months.
- Apparel prices were flat.
- Medical care services prices were up 0.3% and recreation prices were up 0.6%. Because CPI underweights medical care spending (only by households) relative to PCE (which adds in spending by employers and governments) this could receive a higher weight in core PCE when it arrives on January 31st. As the chart below suggests, the updated core CPI reading might translate into an equally sideways movement in core PCE.
- In short, outside of the energy influences, there was fair breadth to the price gains.