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Economics Group

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Consumer Prices Higher Than Expected in February

Consumer prices came in at the high end of expectations in February. While markets were expecting the overall index to be high, the expectation was for the core consumer price index to remain muted.

Consumer Prices Surprise on the Upside

Consumer prices posted a larger-than-expected 0.5 percent increase in February after a print of 0.4 percent in January, taking the year-earlier rate up to 2.1 percent from a previous 1.6 percent. Meanwhile, the all-important, to the Fed at least, core consumer price index, which excludes energy and food prices, also increased by a larger-than-expected 0.2 percent after a similar print for January. The year-over-year core CPI increased to 1.1 percent in February from a 1.0 percent rate in January.

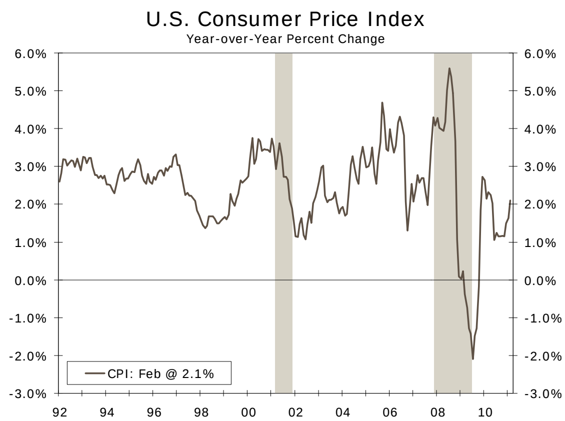
What was even more interesting in the core measure was that the increase in prices was basically broad-based, with important increases in automobile prices, medical care commodities, transportation services and medical care services, whose indices increased by 1.0, 0.7, 0.5 and 0.4 percent, respectively. The only negative contribution to core prices in February was from apparel prices, which dropped by 0.9 percent after a big 1.0 percent increase in January.

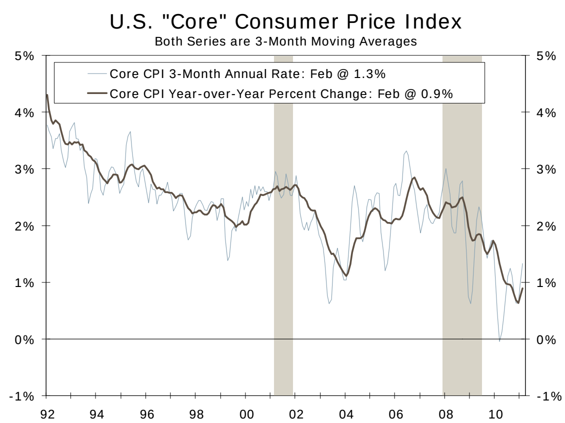
Will the Fed Change Course After This?

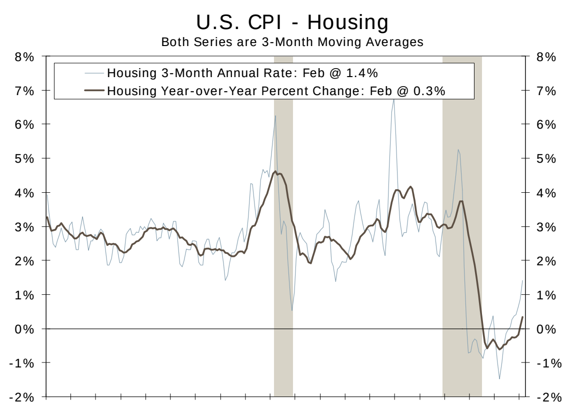
Not yet, the Federal Reserve has indicated that it has been expecting higher prices due to higher energy and food prices, but has also indicated that these increases are mostly temporary. This means that they will likely keep interest rates on hold for the rest of this year. While it is clear that inflation is accelerating, the pace of acceleration is still very slow. Year-on-year growth in core prices has just now crossed the 1.0 rate, at 1.1 percent. According to many, the Fed's implicit target for this rate is 2.0 percent. Thus, there is still room for the Fed to maneuver and be patient.

However, the story for consumer prices over the last several months has been that the economy's condition was not conducive to higher prices at the consumer level because of the big slack that remains on the production side of the economy, while incomes were not rising to support higher prices on the consumer side. Thus, the argument is that firms were not able to pass higher prices of inputs to the consumer.

This argument is essentially correct. However, the economy is improving, even though the rate of improvement is still weak and the rate of unemployment is still very high. But while incomes of current workers may not be increasing, the addition of new jobs every month is adding to total income in the economy and will allow some firms to pass higher input prices into the consumer market. Furthermore, U.S. households received a relatively important increase in incomes at the beginning of the year with the two percent reduction in payroll taxes. This is helping them cope with higher gasoline and food prices as well as use what is left of that money to buy other goods. This means that the deflation talk is no longer in vogue and inflation talk is auditioning for the new role.







Source: U.S. Department of Labor and Wells Fargo Securities, LLC

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