ECONOMIC UPDATE

REGIONS

February 26, 2015

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January Consumer Price Index: . . . Think Of It As Negative Inflation

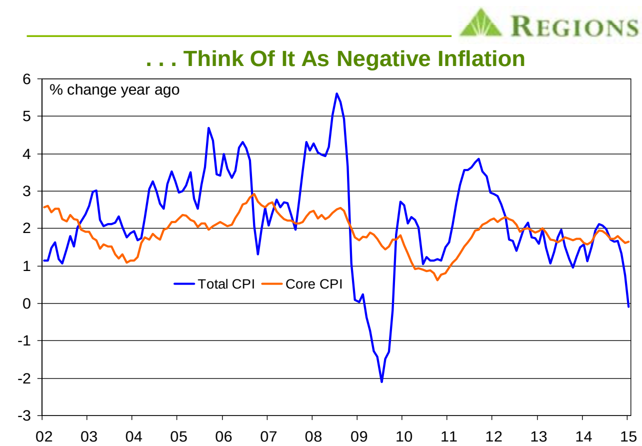
- The total CPI fell 0.7 percent (down 0.680 percent unrounded) in January; the core CPI was up 0.2 percent (up 0.178 percent unrounded).
- On a year-over-year basis, the total CPI was down by 0.1 percent and the core CPI was up by 1.6 percent in January.

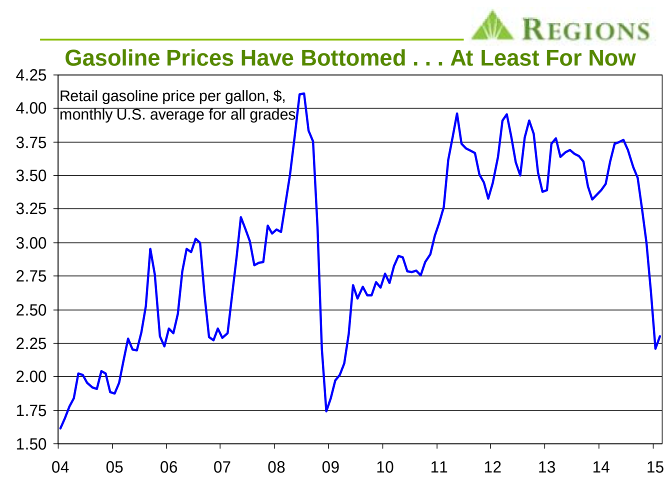
Fueled by rapidly falling energy prices, the total CPI fell by 0.7 percent in January, which translated into a 0.1 percent decline on a year-over-year basis. No, we haven't suddenly become the Euro Zone or Japan – you know, places where deflation is or has been a legitimate concern. Sure, the print on the year-over-year percentage change in the headline CPI is negative, but don't think of it as deflation, think of it as negative inflation. Or, if that doesn't work for you, think of it as you wish but just don't go overboard on drawing sweeping conclusions as to what it tells us about the underlying health of the U.S. economy – nothing, really – or what it might mean for the course of Fed policy – again, nothing, really. What is more relevant is core inflation rose 0.2 percent in January, which yields an over-the-year increase of 1.6 percent, pretty much in line with where core inflation has been over the past few months.

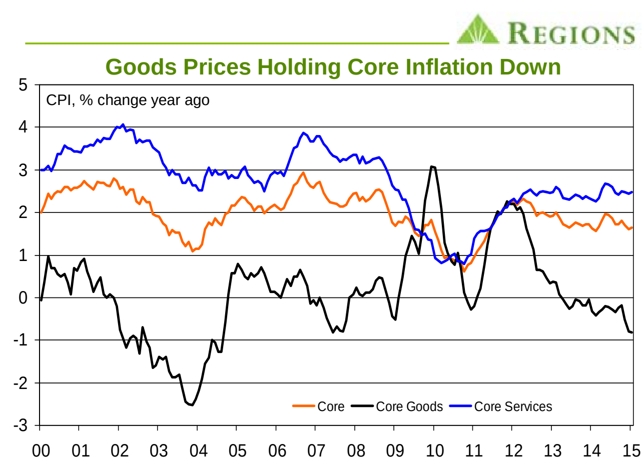
On a not seasonally adjusted basis, retail gasoline prices fell by 17.1 percent as measured in the CPI data. As retail pump prices typically rise in the month of January, the seasonal adjustment process actually magnified the decline in gasoline prices, with a decline of 18.7 percent on a seasonally adjusted basis. This is the primary culprit behind the decline in the headline CPI, the largest monthly decline since December 2008. Food prices were flat in January, as a 0.2 percent decline in prices for food consumed at home negating a 0.2 percent increase in prices for food consumed away from home, a smaller increase than has been seen over the past several months. As for gasoline prices, rather than acting as a drag on the headline CPI, as has been the case in recent months, starting with the February data gasoline prices will have the opposite effect over coming months. Retail gasoline prices typically rise in the month of February as refiners embark on maintenance, taking some refinery capacity off line, ahead of the annual process of switching from production of winter blends of gasoline to more costly summer blends, and retail prices tend to rise through the summer months. This year, however, the typical February price increases have been compounded by strikes amongst refinery workers, taking far more capacity off line than is normally the case and hence leading to a larger than normal increase in retail prices in February. Since hitting their bottom the week of January 26, retail gasoline prices are up 13.2 percent on a national average basis. So, while the year-over-year inflation prints may continue to be impacted over coming months, the month-to-month changes in the CPI will reflect rising, not falling, retail gasoline prices.

Excluding food and energy, the core CPI was up 0.2 percent for the month and core inflation has been fairly stable over recent months, which will help foster a reasonable degree of confidence amongst the FOMC that the underlying trend rate of inflation will ultimately move toward the 2.0 percent target rate once the effects of lower energy prices has worked its way through the data. That said, digging further into the details shows an ongoing dichotomy between prices for non-energy goods and prices for services, as illustrated in the bottom chart. On a year-over-year basis, prices for core goods have fallen 22 consecutive months. While the stepped-up pace of U.S. dollar appreciation has gotten more attention of late, the reality is the dollar has been appreciating for some time now, which has helped push down prices for imported goods. At the same time, however, core services inflation has been running at a steady pace of around 2.5 percent over the past two years. Rents have been a persistent source of support for core services inflation and January was no exception. Market rents rose 0.25 percent in January while owners' equivalent rents were up 0.23 percent, for over-the-year increases of 3.4 percent and 2.6 percent, respectively.

As was the case with the Great Inflation Scare of 2014 – headline inflation running just over 2.0 percent in May and June – the January 2015 headline CPI data will prove to be more noise than signal and, as such, will be heavily discounted by the Fed.







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