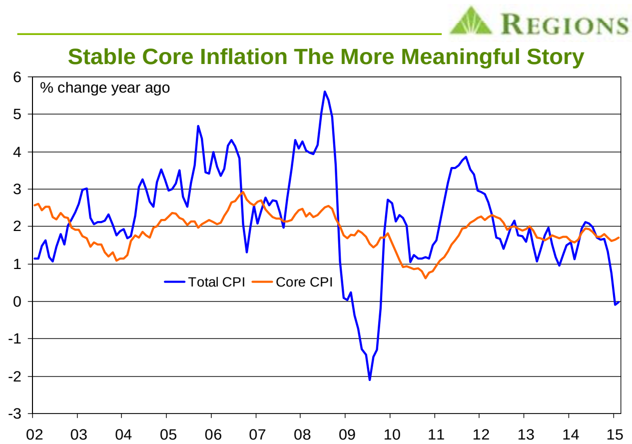
ECONOMIC UPDATE
REGIONS
March 24, 2015

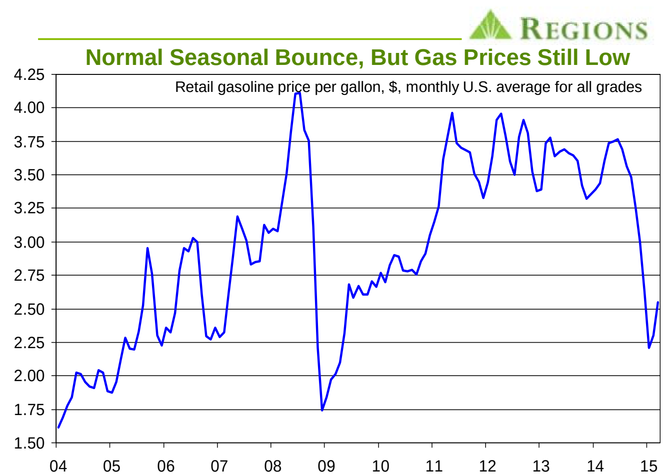
February Consumer Price Index: Stable Core Inflation The More Meaningful Story

- The total CPI rose 0.2 percent (up 0.217 percent unrounded) in February; the core CPI was up 0.2 percent (up 0.157 percent unrounded).
- On a year-over-year basis, the total CPI was flat and the core CPI was up by 1.7 percent in February.

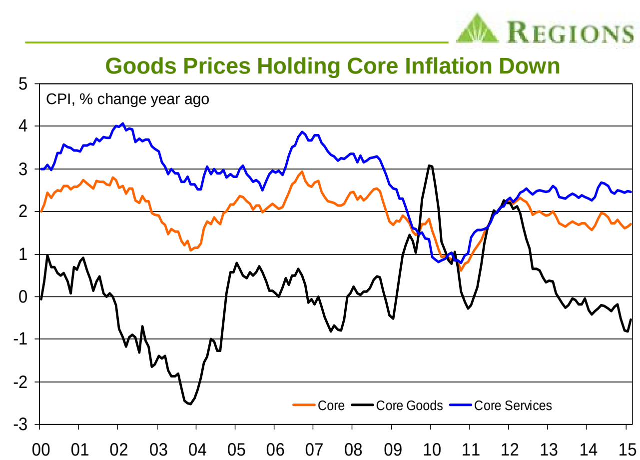
The total CPI rose 0.2 percent in February, the first monthly increase since October, and was flat on a year-over-year basis. By now the monthly CPI report is a familiar tale of the extent to which changes in retail gasoline prices have swayed headline inflation, with February's gain in the total CPI largely fueled by the first monthly increase in retail gasoline prices since June. What, at least to us, is more telling is what has been the relative stability of core inflation for the better part of the past two years. This trend continued in February with the core CPI up 0.2 percent and up 1.7 percent year-on-year. The relative stability of core inflation should mute any concerns about the presence of broader disinflationary pressures in the economy.



Retail gasoline prices as measured in the CPI were up 5.3 percent in February on a not seasonally adjusted basis, following declines of 11.1 percent in December and 17.1 percent in January. Retail pump 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. While seasonal adjustment factors are geared to this annual rite, this year's normal seasonal increase was amplified by the impact of the strike amongst refinery workers which contributed to higher retail prices not so much due to limitations in supply but via the always popular anticipation of supply disruptions. As such, the CPI data show a 2.4 percent increase in retail gasoline prices on a seasonally adjusted basis.



Food prices were up 0.2 percent in February, with prices for food consumed at home up 0.1 percent and prices for food consumed away from home up 0.3 percent. This is the pattern that has been in place for some time now, with restaurant sales one of the fastest growing segments of retail sales, hence allowing for some pricing power amongst restaurant operators. On a year-over-year basis, food prices were up 3.0 percent, with prices for food consumed away from home up 3.1 percent and, despite the mild month-to-month increase, prices for food consumed at home up 2.9 percent (recall the first half of 2014 saw hefty increases in this category, setting a higher base for subsequent over-the-year comparisons). Apparel prices were up 0.3 percent in February, matching the increase seen in January after two sharp monthly declines. On a year-over-year basis, however, apparel prices were down 0.8 percent in February, the fourth consecutive over-the-year decline. New and used car prices rose in February, the first month since last April in which the two rose together. Medical care costs were flat in February, reflecting a split in which prices for prescription drugs and medical care goods were up sharply while prices for medical care services were lower. Rents stuck to script in February, with owners' equivalent rents up 0.2 percent and market rents up 0.3 percent, reflecting year-on-year increases of 2.7 percent and 3.5 percent, respectively.



As noted above, in contrast to headline inflation services inflation has been stable for quite some time now. But, the stability of overall core inflation masks what has been a long-running divergence of the paths of prices for core goods and core services. Core goods prices did rise 0.2 percent in February but were down 0.5 percent year-over-year, the 23rd consecutive over-the-year decline. This is a reflection of softer global prices for many non-labor inputs which has been compounded by an appreciating U.S. dollar, with the pace of that appreciation having picked up sharply over recent months. Meanwhile, core services inflation has settled into a fairly stable trend of about 2.5 percent.

Over the past several months movements in headline inflation have been more noise than signal. The relative stability of core inflation is more meaningful particularly as this will no doubt help the FOMC become "reasonably confident" (this is their characterization) headline inflation will ultimately move back to the 2.0 percent target.

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