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March Consumer Price Index: Inflation Won't Test The FOMC's Patience Any Time Soon

- > The total CPI **rose** by 0.4 percent (0.409 percent unrounded) in March; the core CPI **rose** by 0.1 percent (0.148 percent unrounded)
- > On a year-over-year basis, the total CPI was **up** 1.9 percent and the core CPI was **up** 2.0 percent in March

The total CPI rose by 0.4 percent, in March, as we and the consensus expected, while the core CPI rose by 0.1 percent, shy of the expected 0.2 percent increase. On an over-the-year basis, the total CPI is up 1.9 percent and the core CPI is up 2.0 percent. A methodological change led to a significant decline in apparel prices in March, which is the biggest reason for the miss on the forecast for the change in the core CPI. Even allowing for this, there is little evidence that inflation pressures are intensifying, and rents remain one of the few supports for core inflation. As to headline inflation, gasoline has transitioned from a drag to a driver, and food prices have perked up, particularly grocery store prices. While we'd never go so far as to say food and energy prices don't matter, we do think the FOMC will remain more focused on the path of core inflation and, as such, there is little in the inflation data that will test the FOMC's patience any time soon.

Retail gasoline prices were up by nine percent in March on a not seasonally adjusted basis, an increase that overwhelmed the seasonal adjustment factors and left prices up 6.5 percent on a seasonally adjusted basis. This alone contributed to half of the monthly change in the headline CPI. We expect a similar effect in the April data. The broad energy index jumped 3.5 percent in March. The broad index of food prices was up 0.3 percent in March following a 0.4 percent increase in February, good for a year-on-year increase of 2.1 percent, which is the largest such increase since March 2015. What is more notable is that prices for good consumed at home have now posted back-to-back monthly increases of 0.4 percent, and are up 1.4 percent year-on-year, also a four-year high. What makes the increases seen over the past two months difficult to interpret is that there are no clear-cut catalysts for these changes, with sharp swings in a number of individual categories over the past few months. This of course makes it difficult to draw any conclusions as to whether the increases seen in February and March have staying power, but we'd be surprised if gains of this magnitude persist. Prices for food consumed away from home are easier to account for. While the 0.2 percent increase in March is smaller than those of the prior three months, prices in this category are nonetheless up 3.0 percent year-on-year. We think this reflects what has been strong consumer demand in this category, which has given food providers the leeway to raise prices to help cover rising labor costs.

Core goods prices fell by 0.2 percent for a second straight month, and this leaves them down on an over-the-year basis for the first time since October. Our forecast anticipated core goods prices being a modest support for core inflation in 2019, but this premise is now being tested, thanks in part to a firming of the U.S. dollar since late-2018 which has the effect of holding down prices of imported goods. Primary rents were up 0.4 percent in March, but the unrounded increase of 0.421 percent is the largest February 2007. Though rent growth for rental apartments has moderated, rent growth on single family homes, which now account for a larger share of the rental housing stock than has been the case in the past, remains robust, which is supporting growth in the broad primary rents category. What remains to be seen, however, is whether apartment rents slow enough to offset the support from single family homes, which is what we expect as the sizeable backlog of rental apartment units now under construction begins to clear. Owners' equivalent rents posted a trend-like 0.3 percent increase in March and are up 3.3 percent year-on-year, but it would be reasonable to think that a slowing pace of house price appreciation will ultimately be reflected in slower growth of owners' equivalent rents. For now, though, rents remain the most significant source of support for core inflation, as seen in our bottom chart. For now, there is little in the data to support the common narrative that core services providers have more latitude to pass along higher labor costs in the form of higher prices, but this will bear watching as growth in labor costs accelerates further.

Muted inflation pressures afford the FOMC the latitude to remain patient. We look for core inflation to pick up over the back half of 2019, but not to an extent that will cause the FOMC to raise the Fed funds rate this year.

