ECONOMIC UPDATE

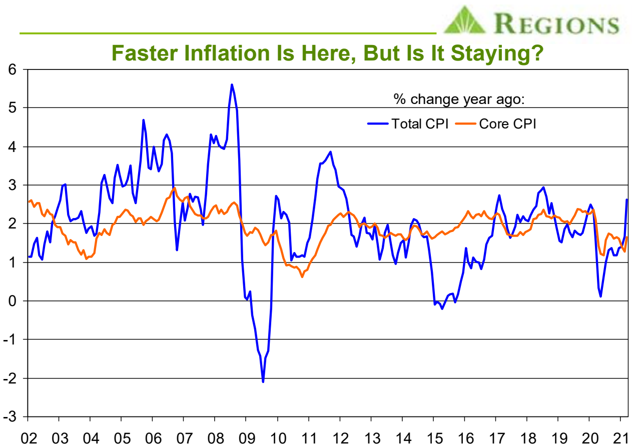
REGIONS

April 13, 2021

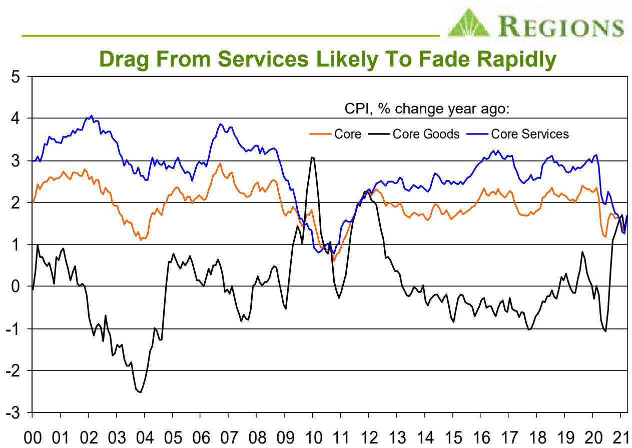
March Consumer Price Index: Faster Inflation Is Here, But Is It Staying?

- The total CPI rose by 0.6 percent in March (up 0.620 percent unrounded); the core CPI rose by 0.3 percent (up 0.339 percent unrounded)
- On a year-over-year basis, the total CPI is up 2.6 percent and the core CPI is up 1.6 percent as of March

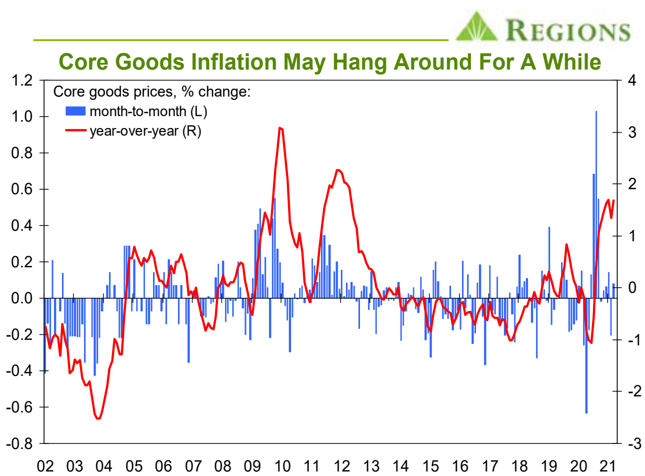
The total CPI rose by 0.6 percent in March, the largest monthly increase since August 2012, while the core CPI was up by 0.3 percent, each matching our forecast but each one-tenth higher than the consensus forecast. On an over-the-year basis, the total CPI is up 2.6 percent and the core CPI is up 1.6 percent as of March. Rising gasoline prices contributed almost half of the increase in the total CPI, while base effects flattered the year-on-year change, which will be the case to an even larger degree in the data for April and May. Still, the monthly increase in the core CPI was the largest in seven months, and with the drag from services prices likely to fade rapidly in the months ahead, core inflation will continue to push higher. The main questions at this point are how high and for how long, as in, how high will inflation go and how long will it stay elevated. The answers will have implications for consumer behavior, market interest rates, and the FOMC.



The broad energy index was up 5.0 percent in March, leaving it up 13.2 percent year-on-year, but that comparison is in the context of energy prices having fallen sharply in March 2020. On a not seasonally adjusted basis, retail gasoline prices were up by 11.7 percent in March, which yielded a 9.1 percent increase in the seasonally adjusted data. Retail gasoline prices have been fairly level over the past four weeks, and while thus far the monthly average for April is above that of March, the seasonally adjusted data for April are likely to show a decline in gasoline prices which will act as a drag on any increase in the total CPI. Prices for food consumed at home and prices for food consumed away from home were up 0.1 percent each. We had expected a larger increase in prices for food consumed away from home in the face of rapidly rising demand. While that was to some extent the case in March, prices at school and other employee dining sites fell sharply for a second straight month, thus limiting the increase in the broader food consumed away from home category. Nonetheless, restaurant pricing will be interesting to watch in the months ahead as more and more customers return.



Core services prices rose by 0.4 percent in March, their largest monthly increase since last July, and are up 1.6 percent year-on-year. Transportation services rose by 1.8 percent in March, with steep increases in prices for rental vehicles, vehicle repair, and motor vehicle insurance. Air fares were up by just 0.4 percent, though larger increases seem likely in the months ahead. Prices for recreation services followed up on February's 0.6 percent increase by rising 0.8 percent in March, while lodging costs jumped by 3.8 percent – though are still down year-on-year. Personal services prices rose by 0.9 percent in March. These are areas in which we expect meaningful price increases in the months ahead as the economy reopens more fully, and rent growth should begin to firm as the labor market recovery progresses. This matters because core services prices have been a notable drag on inflation over the past year, and as that drag fades the result will be faster core inflation. Again, though, the question becomes whether we see steady increases in core services prices or instead one-off "normalizations" in response to increased demand.



Core goods prices rose by just 0.1 percent in March but are up 1.7 percent year-on-year. Prices for used motor vehicles rose by 0.5 percent while prices for new vehicles were flat, but in the months ahead limited inventories, particularly for new vehicles as production is being curbed by the ongoing semiconductor chip shortage, should push vehicle prices higher. Prices for appliances – also impacted by the chip shortage – and furniture were up sharply in March. Core goods prices can be volatile from month to month, but one factor to watch here is the exchange value of the U.S. dollar, as a stronger (weaker) dollar lends downward (upward) pressure to core goods prices.

As with the March data, base effects will distort the inflation readings for April and May. The more relevant question, however, is whether these base effects are masking underlying inflation pressures. We suspect they are, but it will take several months to have a more definitive answer, and the FOMC is willing to patiently await that answer.

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