ECONOMIC UPDATE

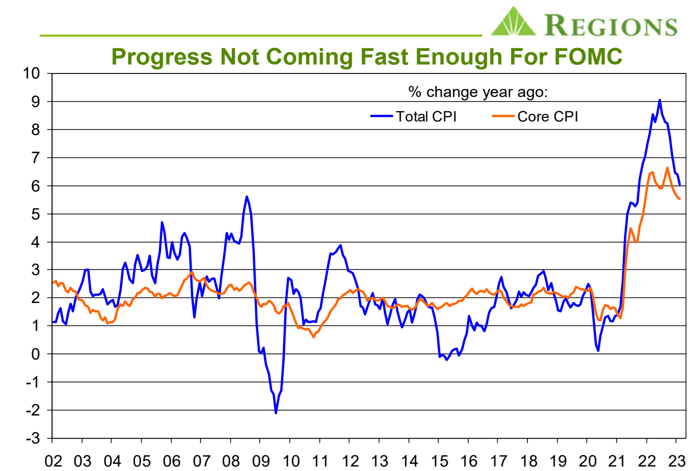
REGIONS

March 14, 2023

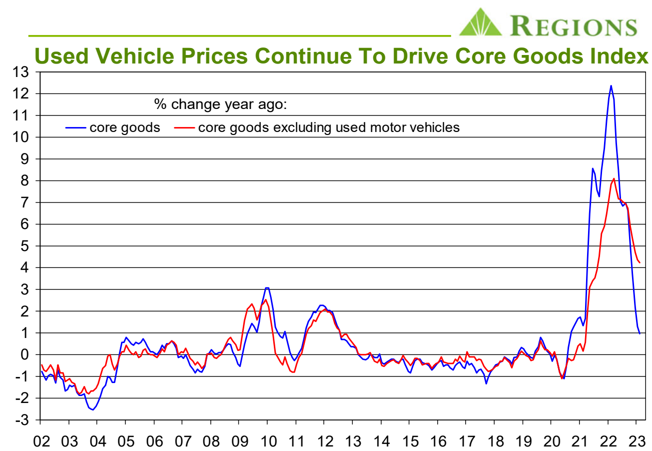
February Consumer Price Index: Progress Not Coming Fast Enough For FOMC

- The total CPI rose 0.4 percent in January (up 0.370 percent unrounded); the core CPI rose 0.5 percent (up 0.452 percent unrounded)
- On a year-over-year basis, the total CPI is up 6.0 percent and the core CPI is up 5.5 percent as of February

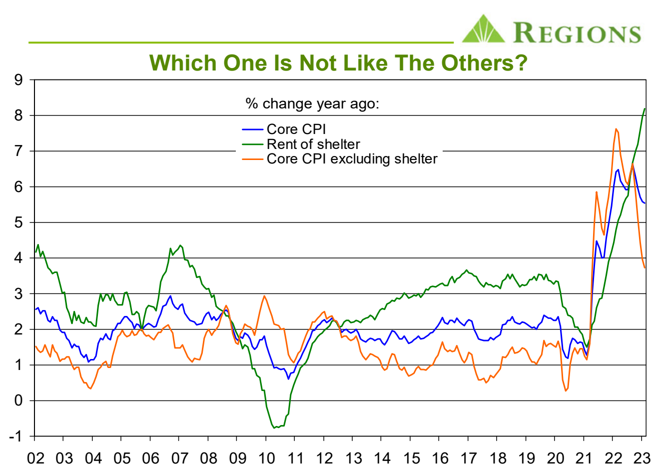
The total CPI rose by 0.4 percent in February with the core CPI rising by 0.5 percent, the former one-tenth slimmer than and the latter matching our forecast (the consensus forecast called for 0.4 increases in the total and core CPI). Right off the bat, however, the reading on the core CPI is highly suspect, as the CPI data show a decline in prices for used motor vehicles in February, which is not only contrary to every market based indicator but the magnitude of that decline, 2.8 percent, is hard to take seriously. That our forecast for the core CPI hit the mark despite our glaring "miss" on used vehicle prices is a function of rent growth and apparel prices coming ahead of our forecasts. Energy was a drag on the headline CPI, while the increase in food prices was smaller than that seen in January. Prices for core goods (consumer goods excluding food and energy) were flat, but that simply reflects the outsized decline in used vehicle prices offsetting what over the past two months have been larger increases across other core goods components, while core services prices were up by 0.6 percent, reflecting not only faster rent growth but also stiff increases in air fares and lodging costs. Coming amid concerns over financial stability, the February CPI data don't really change the story on inflation, which is that, while clearly underway, the disinflation process is just as clearly not moving at a rapid pace or in a straight line, keeping open the prospect of a 25-basis point hike in the Fed funds rate at next week's FOMC meeting despite the stress in the financial system.



The broad energy index fell by 0.6 percent in February despite gasoline prices rising by 1.0 percent on a seasonally adjusted basis. Though retail pump prices fell in each week of February, that they ended January so high above the January monthly average meant that even with the weekly declines, the February monthly average was above that of January. Prices for fuel oil and residential gas services plummeted, reflecting weaker demand thanks to atypically mild weather across much of the U.S. The overall index of food prices rose by 0.4 percent in February, with prices for food consumed at home up by 0.3 percent, the smallest monthly increase since May 2021 which still leaves prices up 10.2 percent year-on-year. Prices for food consumed away from home rose by 0.6 percent as prices at both limited and full service restaurants continue to rise at a rapid clip, which to some extent reflects growth in labor costs.



Core goods prices were, as noted above, flat in February, leaving them up just 1.0 percent year-on-year. As has been the case for some time, however, used vehicle prices remain the dominant factor in the index of core goods prices, which is a reflection of the degree to which used vehicle prices have been changing on a monthly basis as opposed to them carrying an outsized weight in the index. After having risen by 0.5 percent in January, the BLS's series on core goods prices excluding used motor vehicles rose by 0.4 percent in February and is up 4.2 percent year-on-year. Contrary to the 2.8 percent decline reported in the CPI data, the Manheim Index showed used vehicle prices up 4.3 percent in February, the largest monthly increase since February 2009. Hefty increases in apparel and appliance prices lent support to the ex-used vehicles measure of core goods prices.



Primary rents rose by 0.8 percent in February, a larger increase than in January, while owners' equivalent rents logged another 0.7 percent increase, yielding over-the-year increases of 8.8 percent and 8.0 percent, respectively. It will still be at least a couple of months before the CPI measure of primary rents begins to ease, meaning that it will continue to significantly lag changes in going-on market rents. Air fares were up by 6.4 percent in February while lodging costs were up by 2.3 percent, but in each case seasonal adjustment provided a meaningful boost to the reported monthly increase. The CPI measure of medical care services continues to be skewed to the downside by reported declines in prices for health insurance.

The CPI data come with so many caveats – lags here, methodological changes there, seasonal adjustment noise everywhere – that it may be tempting to simply dismiss them. In one sense, however, they are consistent with the PCE Deflator, the FOMC's preferred gauge of inflation, in showing inflation remains much too high for the FOMC's comfort.

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