ECONOMIC UPDATE

REGIONS

January 13, 2021

December Consumer Price Index: Few Signs Of Inflation Pressure As 2020 Ended

- The total CPI rose by 0.4 percent in December (up 0.367 percent unrounded); the CPI rose by 0.1 percent (up 0.085 percent unrounded)
- On a year-over-year basis, the total CPI is up 1.4 percent and the core CPI is up 1.6 percent as of December

The total CPI rose by 0.2 percent in December and the core CPI rose by 0.1 percent, both matching what we and the consensus expected. While goods prices continued to firm up in December, services prices remain listless, acting as a meaningful drag on overall inflation – services prices are assigned a much higher weight in the Consumer Price Index than are goods prices. In particular, rents and medical care costs are weighing on services prices, but more broadly services prices will remain soft until the economy is much further along the path of being fully reopened. For 2020 as a whole, the total CPI rose by 1.2 percent and the core CPI rose by 1.7 percent. While we expect larger increases in each this year, inflation will not likely be a main concern for the FOMC in 2021, particularly since CPI inflation consistently runs ahead of inflation as measured by the PCE Deflator, the FOMC's preferred gauge of inflation.

The broad energy index was up 4.0 percent in December, which nonetheless leaves it down 7.0 percent year-on-year. On a not seasonally adjusted basis, retail gasoline prices were up by 3.4 percent in December, in stark contrast to the declines typically seen in the month of December and which the seasonal adjustment factors are geared for. As a result, the seasonally adjusted data show an 8.4 percent increase in gasoline prices, which alone added three tenths of a point to the monthly change in the total CPI. Fuel oil prices jumped by 10.0 percent in December yet were down 20.0 percent year-on-year. Food prices rose by 0.4 percent in December, a larger increase than our forecast anticipated. Prices in each of the main components – food consumed at home and food consumed away from home – saw the same 0.4 percent increase, and while the former does not surprise us, the latter does. Restaurants in many parts of the U.S. faced new operating restrictions, while the arrival of winter weather curtailed outdoor dining, but pricing, particularly at limited service establishments, held up better than we had expected.

Core services prices were up by just 0.08 percent in December, leaving them up 2.2 percent year-on-year. But, as our middle chart shows, core services prices continue to lose momentum and are likely to remain listless through most, if not all, of the first half of 2021. One culprit is decelerating rent growth; primary rents were up 0.1 percent in December, and the 2.27 percent year-on-year increase is the smallest such increase since September 2011. While rents have weakened considerably since the onset of the pandemic, we had been pointing to softening rent growth for some time prior and had expected supply increases to lead to further softening. Over recent months, however, there has been a downshift in demand that has only amplified pressures on rent growth. Until the labor market is more fully healed, which we do not expect to be soon, it may be hard for rent growth to gain much traction, particularly with supply side issues still lurking in the background. Another weight on core services prices over the past several months has been health care costs. The CPI's gauge of medical costs fell by 0.2 percent in December, the fourth consecutive monthly decline. Outside of hospital services, pricing trends have deteriorated amongst the various components of the index of medical care costs. It is, however, reasonable to expect that prices for physicians' and dental services to rebound, perhaps sharply, later in 2021. We think that is true of services prices in general – once the economy is more fully reopened, there is bound to be a normalization in services prices, though we think this will be more of a one-off adjustment rather than a sustained period of rising services prices, and this distinction would matter to the FOMC.

In contrast to softening services prices, core goods (i.e., excluding food and energy) prices continue to firm, rising by 0.2 percent in December, with the year-on-year increase of 1.6 percent the largest since April 2012. Core goods prices are being pushed higher by continued strong consumer demand and a weaker U.S. dollar; while we expect the former to be sustained through 2021, we do not expect the weakness in the dollar to persist through the year. Still, on net, core goods prices will likely continue to push higher over the course of 2021.

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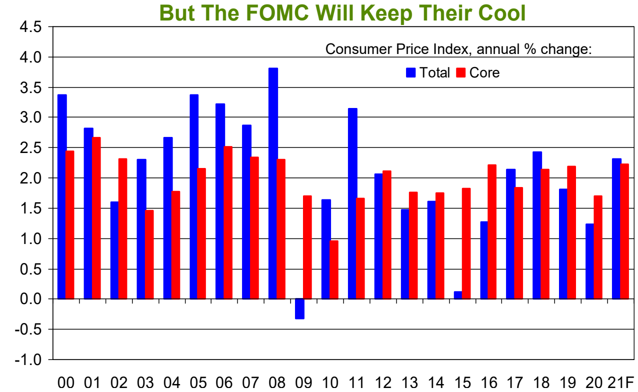
Inflation Set To Warm Up In 2021, But The FOMC Will Keep Their Cool



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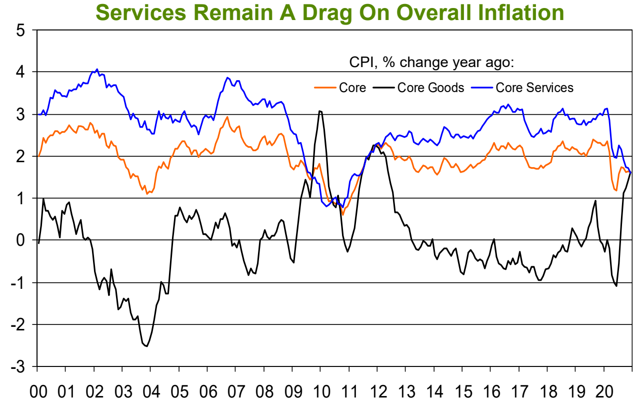
Services Remain A Drag On Overall Inflation



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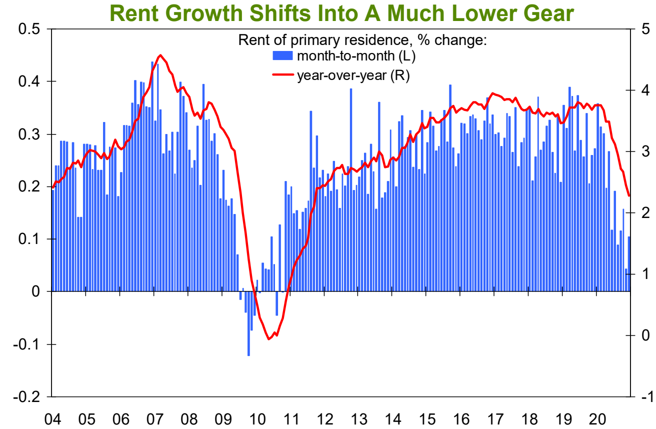
Rent Growth Shifts Into A Much Lower Gear



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