ECONOMIC UPDATE

REGIONS

March 10, 2021

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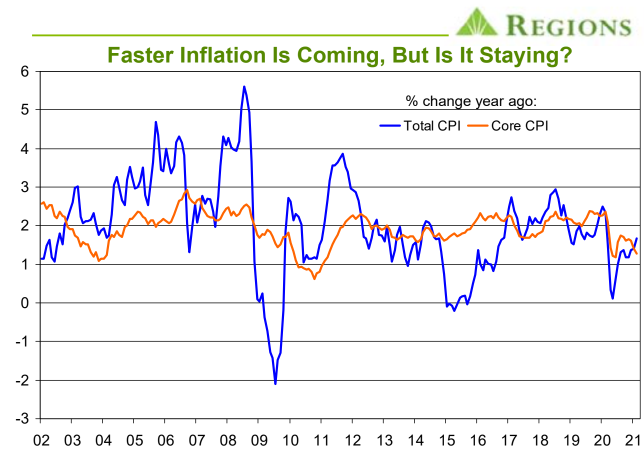
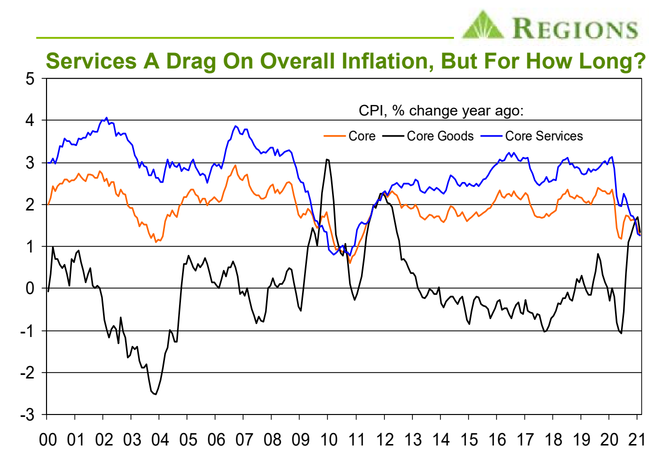
February Consumer Price Index: Faster Inflation Is Coming, But Is It Staying?

- The total CPI rose by 0.4 percent in February (up 0.354 percent unrounded); the core CPI rose by 0.1 percent (up 0.101 percent unrounded)
- On a year-over-year basis, the total CPI is up 1.7 percent and the core CPI is up 1.3 percent as of February

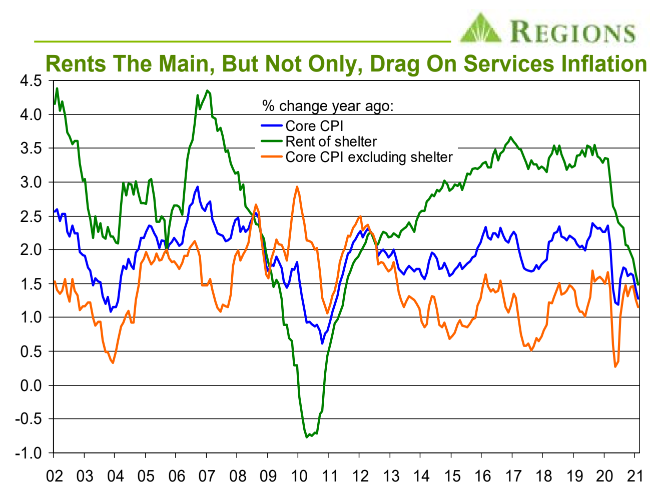
The total CPI rose by 0.4 percent in February, matching the consensus forecast but shy of our forecast of a 0.5 percent increase, while the 0.1 percent increase in the core CPI was smaller than the 0.2 percent increase we and the consensus expected. On an over-the-year basis, the total CPI is up 1.7 percent and the core CPI is up 1.3 percent as of February. Our above-consensus forecast anticipated jumps in food and energy prices, both of which were impacted by February's unusually harsh winter weather, and while the increase in energy prices was in line with our forecast, food prices rose less than we anticipated. At the same time, a surprise decline in core goods prices weighed on both the total and core indexes. At 1.7 percent, headline CPI inflation is running at its fastest pace in a year, and that pace will accelerate significantly as the data for March and April come in. Recall that prices tumbled in those months last year as the economy shut down, so the over-the-year comparisons in March and April of this year will be much easier, to the point that with just 0.1 percent increases in March and April, the year-on-year increase in the total CPI would top 3.0 percent in the April data. That, however, will say much more about what was happening a year ago than what is happening now, and those base effects will subside in subsequent months. As such, the FOMC, and presumably most market participants, will look past these base effects. What remains to be seen is whether there are factors that will have a more lasting effect on inflation in the months ahead.



The broad energy index was up 3.9 percent in February, which nonetheless left it up just 2.4 percent year-on-year. On a not seasonally adjusted basis, retail gasoline prices were up by 6.9 percent in February – after a like-sized increase in January – which translated into a 6.4 percent increase in the seasonally adjusted data. Prices for home heating fuels jumped by 11.1 percent while prices for electricity and residential gas service posted well above trend increases. Food prices rose by 0.2 percent in February which, as noted above, was a smaller increase than we anticipated. Prices for food consumed at home rose by 0.3 percent while prices for food consumed away from home were up by 0.1 percent. It could be that we were just early in our call on food prices in terms of the fallout from harsh winter weather working their way down, well, down the food chain, so this will bear watching in the March data. Either way, food prices are up 3.6 percent year-on-year.



Core services prices rose by 0.2 percent in February, the largest monthly increase since July. While market rents rose by 0.2 percent, ending a run of three straight monthly increases of 0.1 percent, year-on-year growth continued to decelerate, with February's 1.96 percent year-on-year increase the smallest since July 2011. While slowing rent growth has acted as a drag on core services inflation over the past several months, there have been other factors in play. Specifically, with much of the services sector either effectively shut down or operating under capacity limitations, core services prices have been listless. But, as the economy more fully reopens in the months ahead, it is reasonable to expect services prices to normalize amid what should be a significant increase in demand. That will provide a boost to overall inflation, but any such normalization is unlikely to persist, such that there will be no longer-run effects on inflation.



Core goods prices slipped by 0.2 percent in February, ending an eight-month run in which core goods prices were either flat or higher. Prices for apparel, home furnishings, prescription and nonprescription drugs, and used motor vehicles fell in February while prices for new motor vehicles were flat. 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.

While base effects and normalization of services prices should have transitory effects on inflation, potential sources of more lasting inflation pressures are higher gasoline prices, higher raw commodity prices, and higher shipping costs, with the exchange value of the U.S. dollar lurking as a wild card that could go either way.

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