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## January Consumer Price Index: The “Why” May Not Matter, The “How Much” Will . . .

- The total CPI rose by 0.6 percent in January (up 0.645 percent unrounded); the core CPI rose by 0.6 percent (up 0.583 percent unrounded)
- On a year-over-year basis, the total CPI is up 7.5 percent, and the core CPI is up 6.0 percent as of January

The total CPI rose by 0.6 percent in January, as did the core CPI, each two-tenths more than we and the consensus expected. On an over-the-year basis, the total CPI is up 7.5 percent as of January, the largest such increase since February 1982, while the core CPI is up 6.0 percent, the fastest rate of core CPI inflation since August 1982. There are a few factors that contributed to the upside beat in the January CPI readings, none of which will change the bottom, or top for that matter, line, but which we think worth noting. First, the January data incorporate the annual revisions to recent historical data and the updated seasonal factors used to produce the seasonally adjusted estimates. Second, the January data incorporate new expenditure weights, based on consumer expenditure data over the 2019-2020 period. While the BLS regularly updates the weightings in the CPI data based on surveys of consumer expenditures, this particular update is more impactful than most given that it incorporates the dramatic shift in expenditure patterns during the pandemic. Recall that with much of the services sector shut down and consumers flush with funds from various pandemic-related transfer payments, consumer spending on goods rose sharply, particularly spending on consumer durable goods, at a time when global production went on hiatus and supply chains became snarled. The result was a significant acceleration in the rate at which goods prices were increasing. So, with core goods (consumer goods excluding food and energy) now carrying a greater weight in the CPI and what remains rapid goods price inflation, the result is a faster rate of inflation.

More fundamentally, the January CPI data show larger increases in primary rents and medical care costs than our forecast anticipated. Kind of. We’ve been noting for some time now that medical care costs, as measured in the CPI, had been oddly tame since the onset of the pandemic but it was only a matter of time before that would change. So, while it is too soon to know whether the 0.7 percent increase in medical care costs reported in the January CPI data marks the start of that change or is just a one-off bump, this does merit attention in the months ahead. As to rents, we’ve noted that the CPI measure of primary (or, market) has tended to lag other indicators which over recent months have shown significantly faster rent growth than has the CPI, and that it was only a matter of time before the CPI data picked up faster rent growth. Primary rents rose by 0.5 percent in January, larger than the recent run-rate and the largest (unrounded) increase since March 1992, thus contributing to larger changes in the total CPI and core CPI than our forecast anticipated. Our premise has for some time been that rents and medical care costs would rise at a faster rate in 2022, thus helping to sustain inflation pressures even as goods prices begin to ease, as we expect they will over the second half of this year.

If you didn’t like the January CPI data, you’ll like the February data even less. Seasonally adjusted gasoline prices fell by 0.8 percent in January, thus acting as a drag on the total CPI. Based on the increases to date in February, however, rising gasoline prices figure to add at least two-tenths of a point to the February change in the total CPI, which will push inflation even higher. At the same time, prices for new motor vehicles were flat in January, which stands out given the hefty increases seen over the past year. Granted, domestic motor vehicle production has been increasing, albeit off of a very low base, which should take some of the pressure off of new vehicle prices, but not to the extent reported in the January CPI, so there could be some payback in the February data.

We get that 7.5 percent inflation is 7.5 percent inflation, and the “why” won’t necessarily matter to nearly the same degree as the “how much.” Keep in mind, however, that while the shift in weightings based on pandemic-era spending patterns is contributing to faster measured inflation, both now and in the recent past, the flip side will be a faster deceleration in inflation at some point down the road. If we are correct in expecting goods prices to ease over the second half of 2022, that will lead to a faster deceleration in inflation than would have been the case absent the shift in expenditure weights. This could alter the timing, but not the ultimate extent, of FOMC policy moves.

