

## US CPI INFLATION MODERATES IN FEBRUARY, CALMING NERVES

*\*Market participants can rest easy over inflationary concerns, as the headline U.S. Consumer Price Index (CPI) moderated to a 0.15% m/m gain in February, after the outsized 0.54% m/m January increase, while the core (excludes food and energy) increased by 0.18% m/m after the 0.35% January gain. The headline and core CPI increased by 2.2% yr/yr and 1.8% yr/yr, respectively, in line with recent increases (Chart 1)*

*\*The February increase in the core CPI is more indicative of the underlying trend with the sizable gains in prior months resulting from outsized increases in a few items — some of which corrected in February (Chart 2)*

*\*Consumer prices have firmed since late last year as a result of robust economic momentum and labor market performance. Moderate increases in inflation are expected to continue and the rolling-off of idiosyncratic factors that weighed on inflation in 2017 will provide a modest boost*

The details of the February CPI suggest **that the Fed's preferred measures of prices, the headline and core PCE price indexes, probably increased 0.1% m/m and 1.7% yr/yr, and 0.2% m/m and 1.5% yr/yr, respectively, in February.** The February PCE data are scheduled for release on March 29 (after the **Fed's March 20-21** meeting), but the CPI data today and other recent economic indicators are more than enough to enable the Fed to increase its policy rate at its meeting next week.

Of the 62 primary categories of the CPI, 39 increased in February, above the 2017 trend but below the trend in prior years, suggesting that, while inflation is firming, price increases are not very widespread and there is still room for broader gains (Chart 3).

A few key notes from the February CPI: 1) new and used vehicle prices that surged due to strong hurricane replacement demand both declined in February (Chart 4); 2) hospital services prices fell 0.5% m/m in February, the first decline in the series since September 2016 after the 1.3% January jump; 3) apparel prices continued to increase at a fast pace in February after mostly declining in recent years (Chart 5); and 4) shelter prices increased 0.2% m/m in February and bears close watching as it accounts for 33% of the CPI and has propped up overall inflation in recent years.

In the March report released next month, the sharp drop in cellphone services prices from March 2017 will roll off the 12-month inflation change and could boost core CPI inflation by as much as 0.2 percentage point (Chart 6).

The weak U.S. dollar has pushed up import prices of consumer goods, moderately, with some lag and could provide a small lift to consumer goods price inflation in coming months. The tariffs on steel and aluminum may place some upward pressure on vehicle prices, furniture, household supplies, and electronics and appliances, but the aggregate impact is likely to be minor. We expect most of the increases in domestic consumer price inflation to come from services prices as services account for the bulk of economic activity.

Improved wage growth does not necessarily mean an acceleration in inflation. Improved wage growth that is accompanied by better productivity gains will constrain increases in unit labor costs, allowing firms to maintain margins without raising prices significantly.

13 March 2018

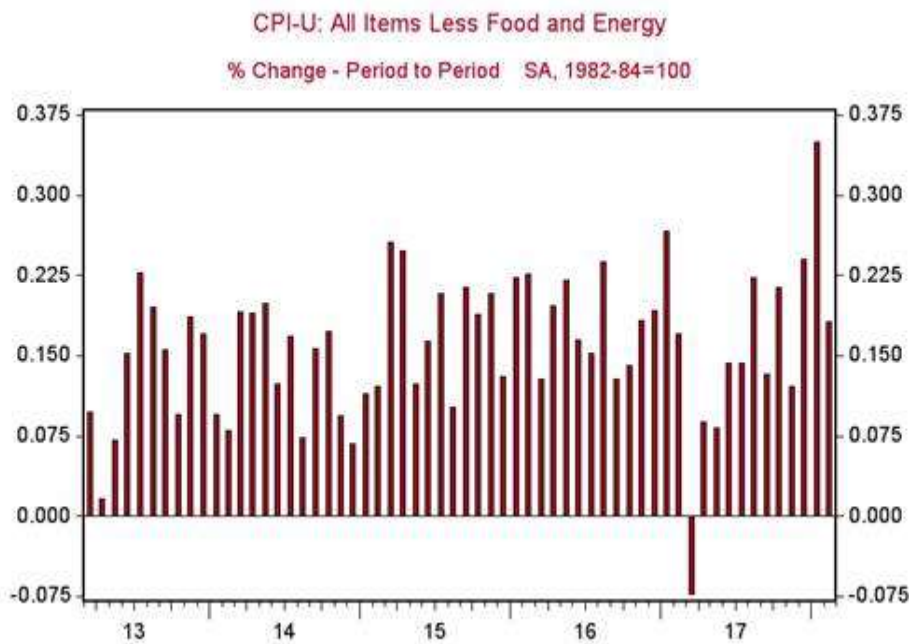
Chart 1: CPI - All items, and CPI - Less Food and Energy (year-over-year, %)



Source: Bureau of Labor Statistics/Haver Analytics

Source: Monthly data. Source: Bureau of Labor Statistics and Haver Analytics

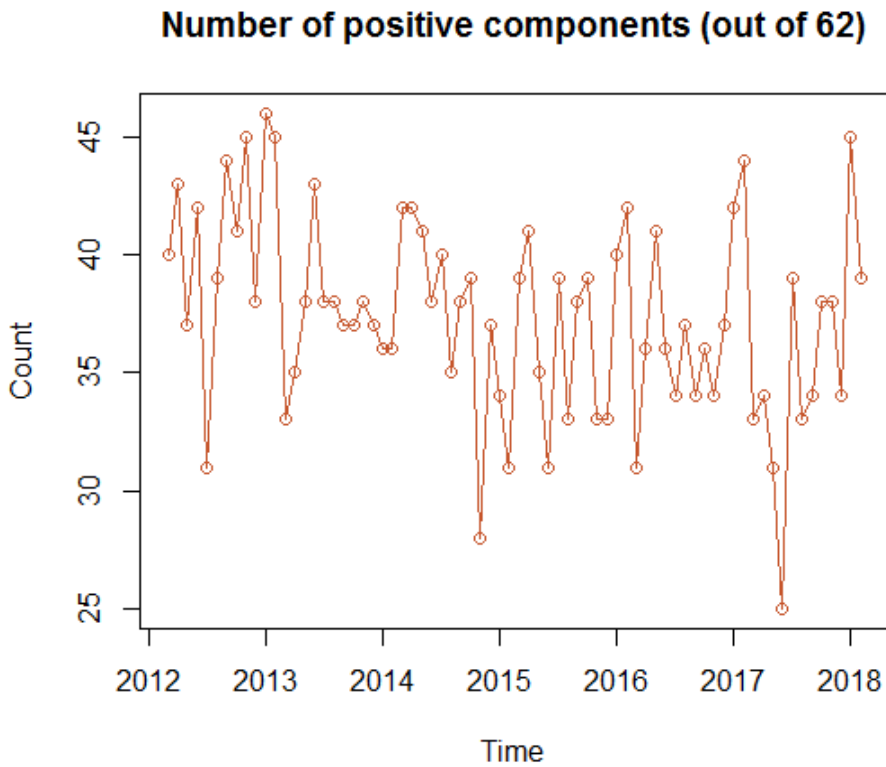
Chart 2: CPI: All Items Excluding Food and Energy (month-over-month, %)



Source: Bureau of Labor Statistics/Haver Analytics

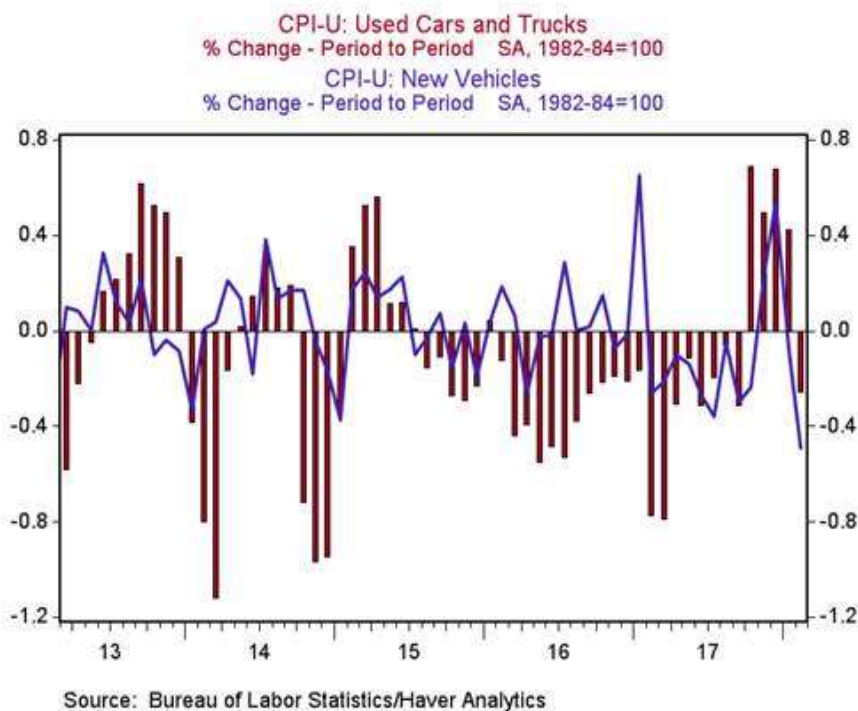
Source: Monthly data. Source: Bureau of Labor Statistics and Haver Analytics

Chart 3: Number of CPI Components Increasing On a Month-Over-Month Basis



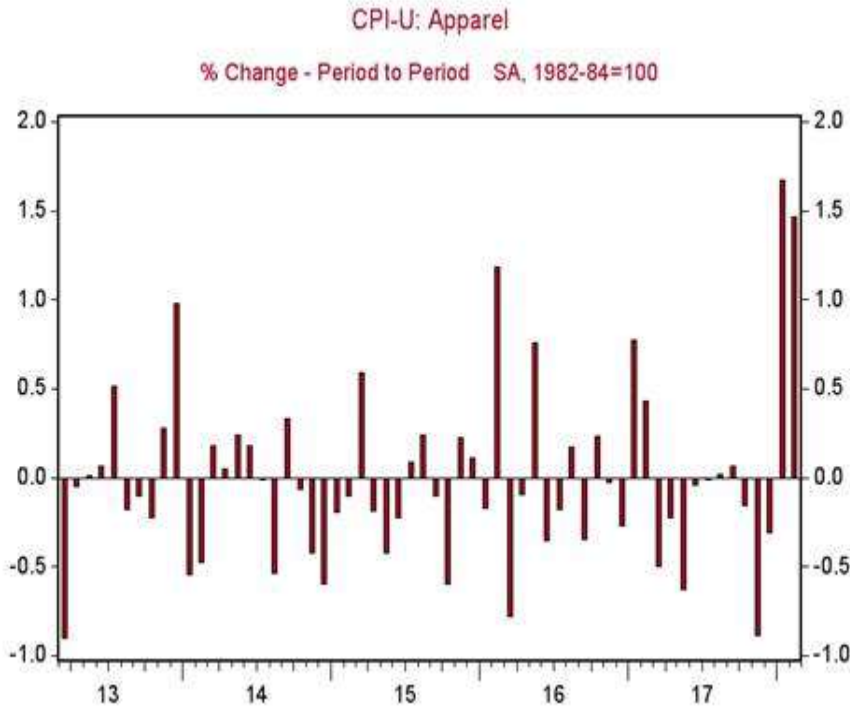
Source: Monthly data. Source: Bureau of Labor Statistics and Berenberg Capital Markets

Chart 4: CPI for Used and New Vehicles (month-over-month, %)



Source: Monthly data. Source: Bureau of Labor Statistics and Haver Analytics

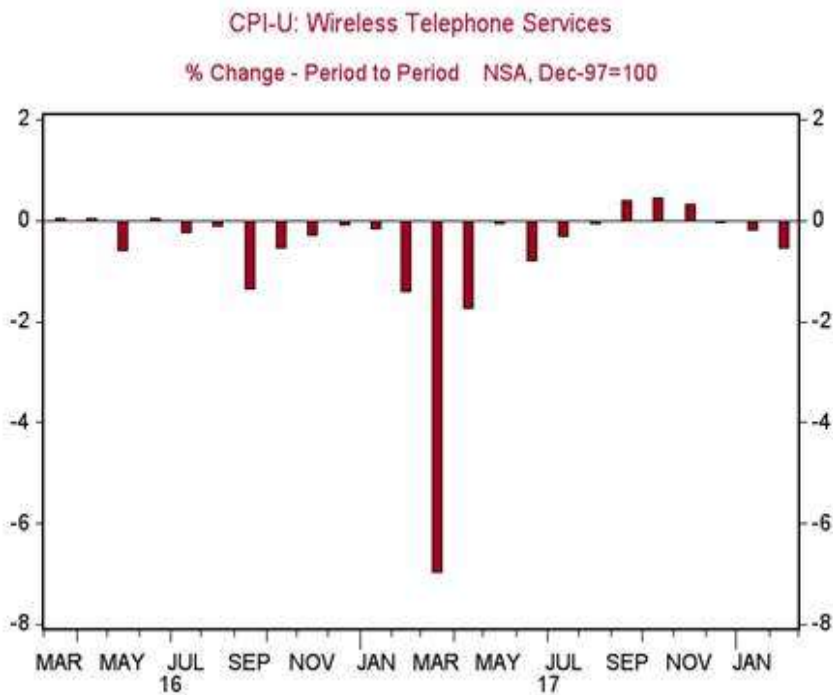
Chart 5: CPI for Apparel (month-over-month, %)



Source: Bureau of Labor Statistics/Haver Analytics

Source: Monthly data. Source: Bureau of Labor Statistics and Haver Analytics

Chart 6: CPI for Wireless Telephone Services (month-over-month, %)



Source: Bureau of Labor Statistics/Haver Analytics

Source: Monthly data. Source: Bureau of Labor Statistics and Haver Analytics

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