

US: PICK UP IN ENERGY PRICES PUSHES HEADLINE CPI UP TO CORE CPI AT END OF 2016

**The US headline Consumer Price Index (CPI) rose 2.1% yr/yr in December, climbing closer to the core CPI (excludes food and energy) as the drag from energy prices has diminished*

**Rents and medical care service prices pushed up core inflation in 2016*

**If the anticipated fiscal reforms generate an acceleration in economic growth, businesses will have greater pricing power, and wages will accelerate. Fed will be on the lookout*

The US headline Consumer Price Index (CPI) rose 2.1% yr/yr in December, climbing closer to the core CPI (excludes food and energy) - up 2.2% yr/yr - as the drag from energy prices has diminished (see Charts 1 and 2). The core CPI has been above 2% since **November 2015, leading the Fed's preferred measure of inflation, the core PCE deflator**, which is still just under 2%.

Core services CPI (which excludes energy) is still increasing at a fast pace (over 3%). Acceleration has come from: (1) rent prices - low vacancy rates and the jump in mortgage rates, which will probably make renting more attractive than buying, will continue to push up rent inflation (see Charts 3 and 4) and (2) medical care service prices - accelerated by a large 3.9% in 2016, but there is uncertainty around future price gains due to likely changes to health care policy (see Chart 5).

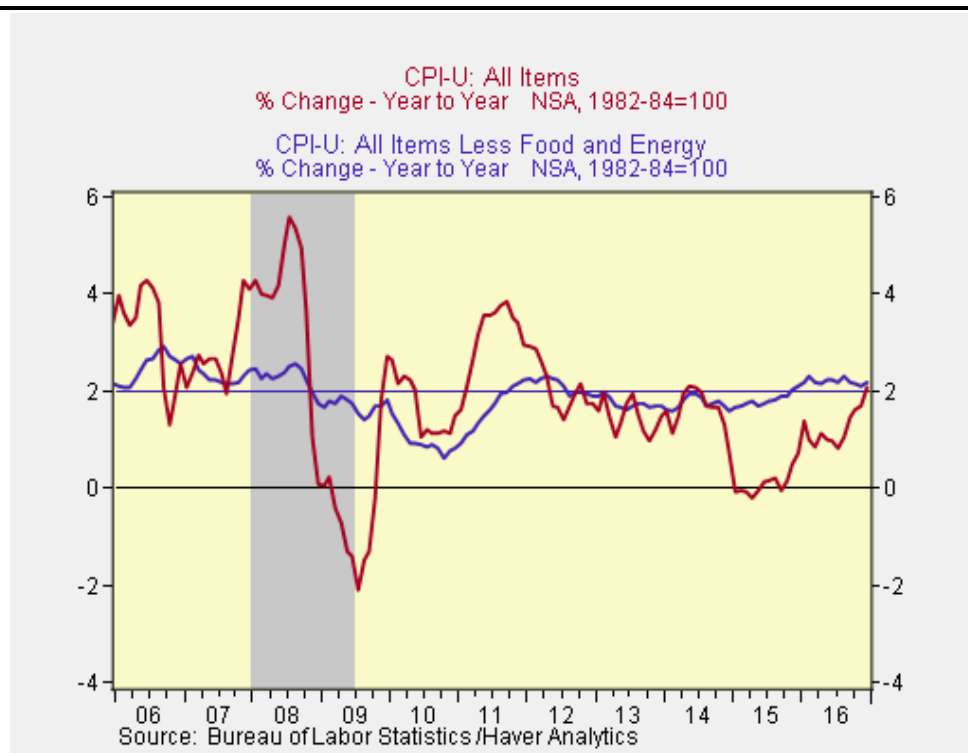
If the anticipated fiscal reforms generate an acceleration in economic growth, businesses will have greater pricing power. Indeed, the National Federation of Independent Business December report showed a jump in the net share of small businesses planning to raise average selling prices, equalling its highest level in this economic recovery (see Chart 6).

The low unemployment seems to finally be feeding through to wage inflation. Moreover, if the infrastructure spending increases demand in construction and related sectors that already face labor shortages, there will be even more upward pressure on wages.

Low inflation has allowed the FOMC to be comfortable in its extremely accommodative policy stance, but it will be on the lookout for any price pressures showing signs of overheating in the economy. The risks are for more Fed rate hikes than currently expected.

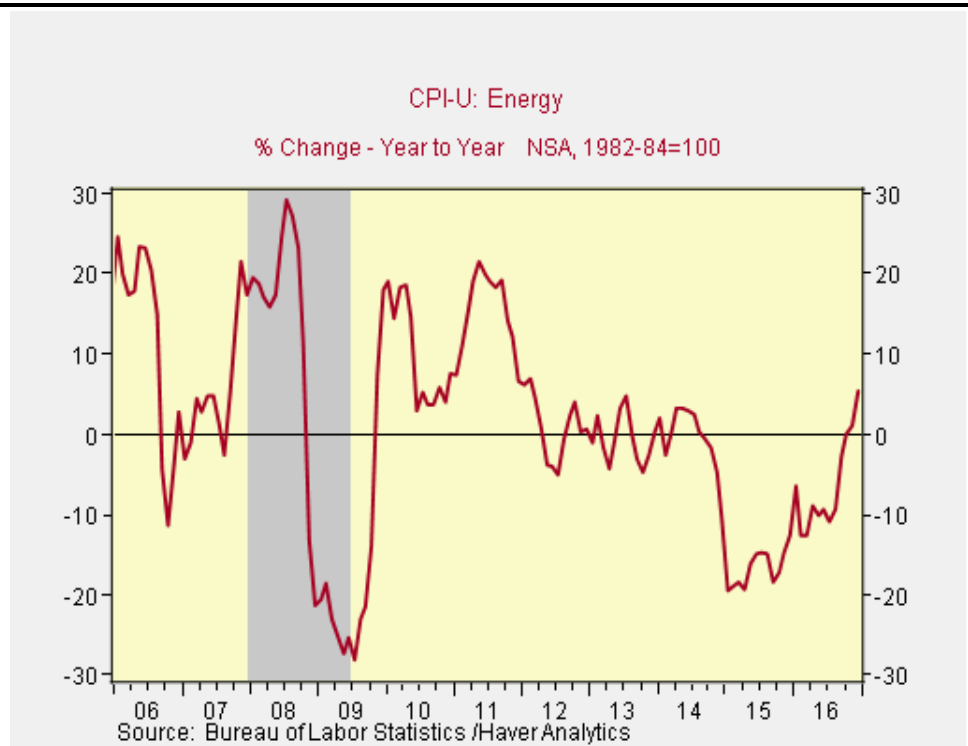
18 January 2017

Chart 1: Headline CPI and Core CPI (Year-Over-Year, %)



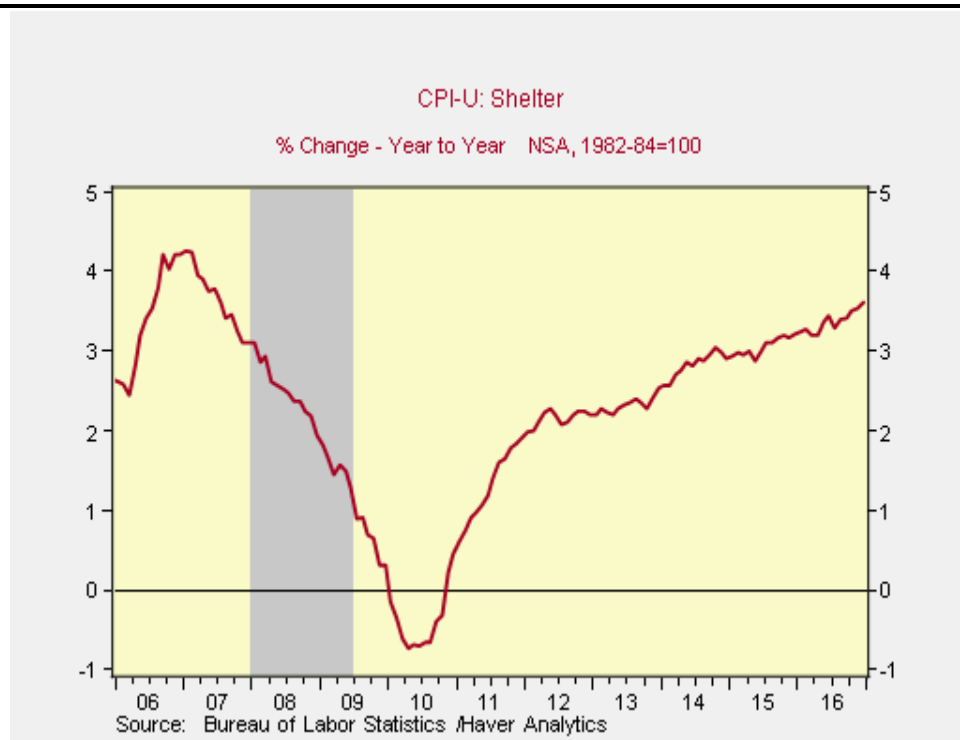
Source: Monthly data. Source: Bureau of Labor Statistics and Haver Analytics

Chart 2: Energy CPI (Year-Over-Year, %)



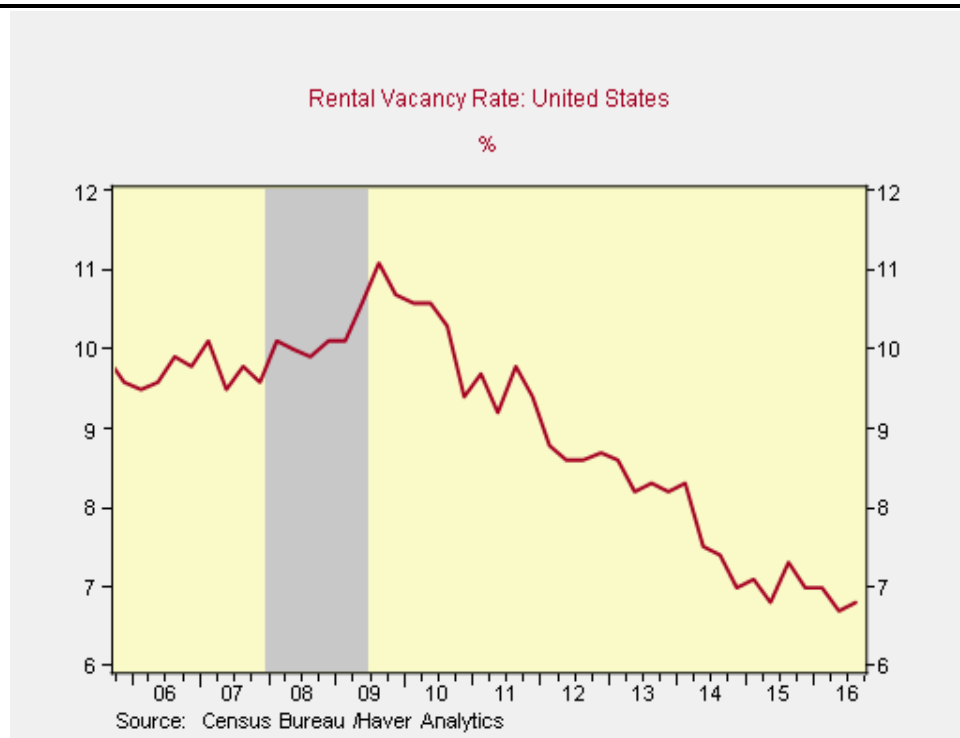
Source: Monthly data. Source: Bureau of Labor Statistics and Haver Analytics

Chart 3: Shelter CPI (Year-Over-Year, %)



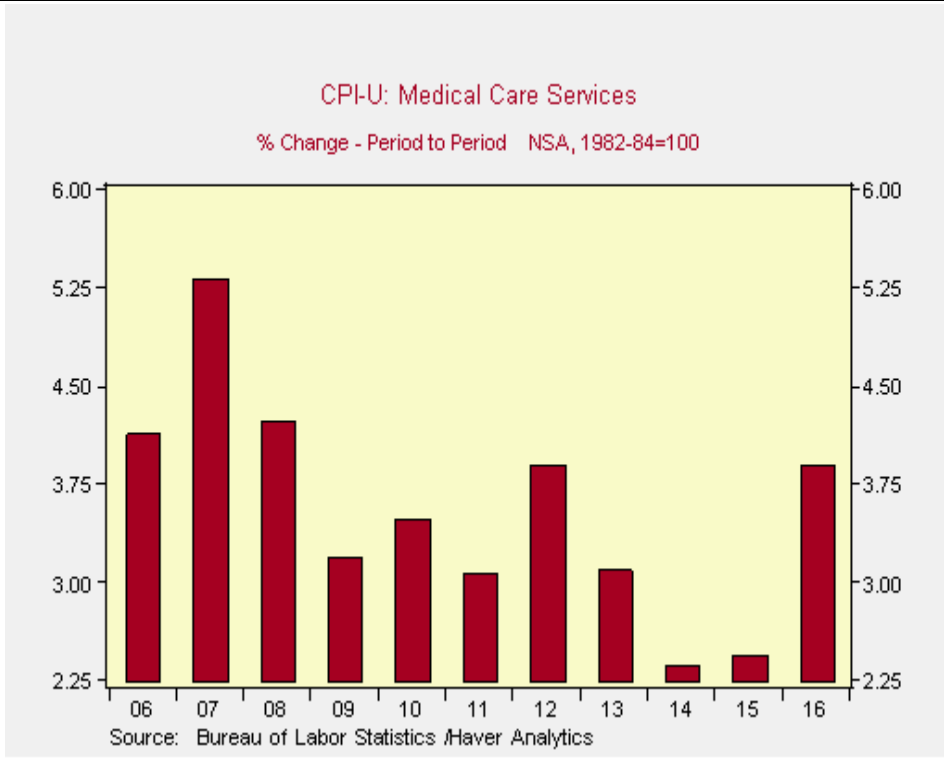
Source: Monthly data. Source: Bureau of Labor Statistics and Haver Analytics

Chart 4: Rental Vacancy Rate



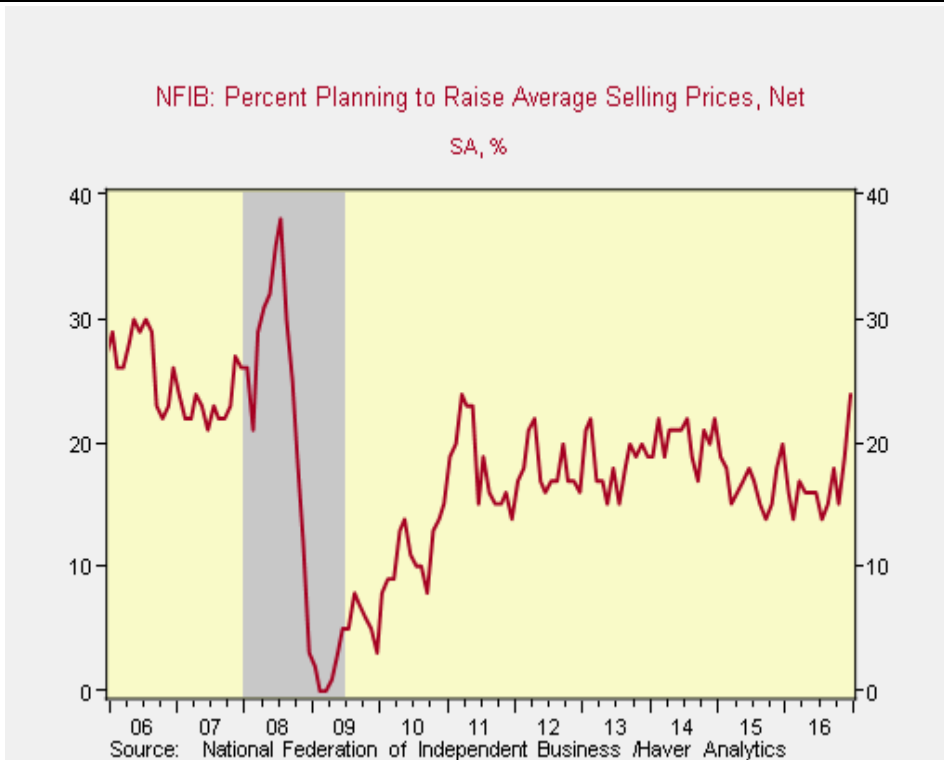
Source: Quarterly data. Source: Census Bureau and Haver Analytics

Chart 5: Medical Care Services CPI (Year-Over-Year, %)



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

Chart 6: Small Businesses' Plans for Selling Prices



Source: Monthly data. Source: National Federation of Independent Business and Haver Analytics

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