

## US PCE DEFLATOR ADVANCES 1.9% IN JANUARY PLACING PRESSURE ON FED TO ACT

*\*The Personal Consumption Expenditures (PCE) deflator advanced 1.9% yr/yr in January*

*\*The Fed is expected to increase rates at its March meeting with inflation finally at its 2% target*

*\*The acceleration in the PCE deflator translated to a decline in private consumption in real terms*

The **Fed's preferred measure of consumer inflation, the PCE deflator advanced 0.4% m/m and 1.9% yr/yr in January**, the highest annual pace since October 2012, putting **it right at the Fed's 2% inflation target** (see Chart 1). The PCE deflator has made significant progress over the last year (from +1.1% yr/yr in January 2016 to +1.9% yr/yr in January 2017) with energy prices finally making a positive contribution (+11.8% yr/yr in January).

The Fed needs to acknowledge and act on the significant progress made towards its goals. With the pickup in inflation, strong labor market performance, optimistic sentiment, hawkish Fed speak and the fed funds futures implied probability for a March rate hike at 82%, the Fed would be remiss not to increase rates at its March meeting (see "[March Fed rate hike seems most likely](#)", February 17, 2017). Look to Fed Chair Yellen's and Vice Chair Fischer's speeches on Friday for the last word on the likelihood of a rate hike at its March 14-15<sup>th</sup> meeting.

Signs of building inflationary pressures via producer prices, inflation expectations, and business surveys have to be watched very closely, for signs of an overheating economy in an environment where fiscal reform is expected to stimulate growth.

The acceleration in the January PCE deflator reduced real private consumption, which fell by 0.3% m/m. Q1 real private consumption will likely grow closer to 2% in Q1, compared to the 3% pace in Q4.

Personal incomes rose by a solid 0.4%, pushing the personal saving rate up to 5.5% - a relatively elevated level that consumers can draw down on in case of shock and also provides more opportunity to increase discretionary spending (see Chart 2). Additionally, the continued rally in equity prices, multiyear highs in consumer confidence, and prospects for cuts in individual tax rates all point to a consumer that is in good shape (see Chart 3).

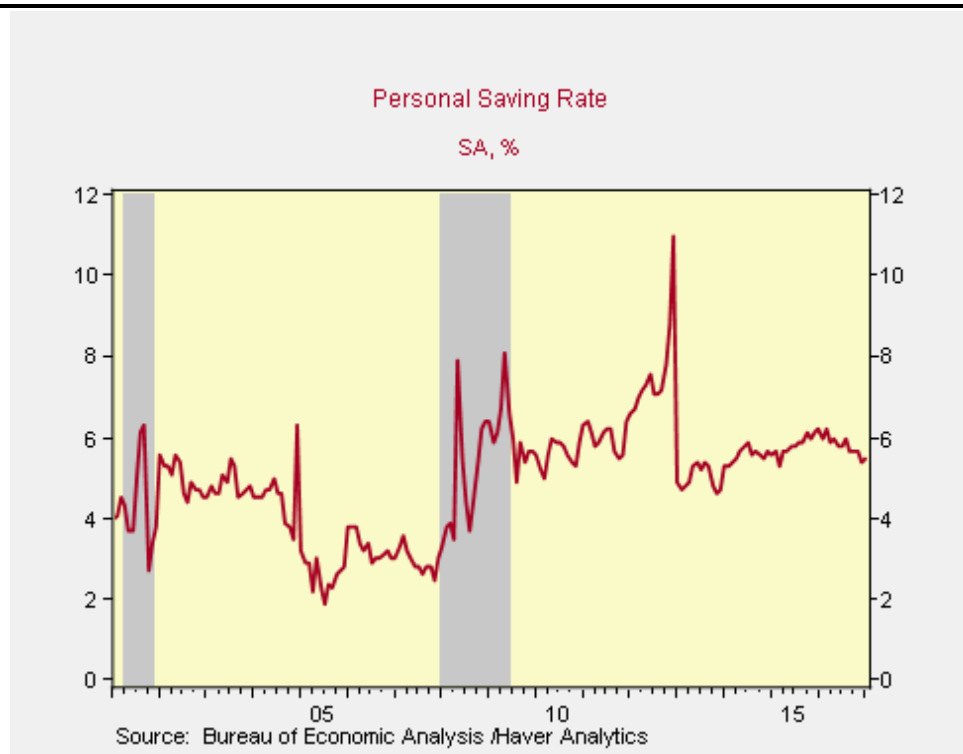
01 March 2017

Chart 1: PCE Chain Price Index (Year-Over-Year, %)



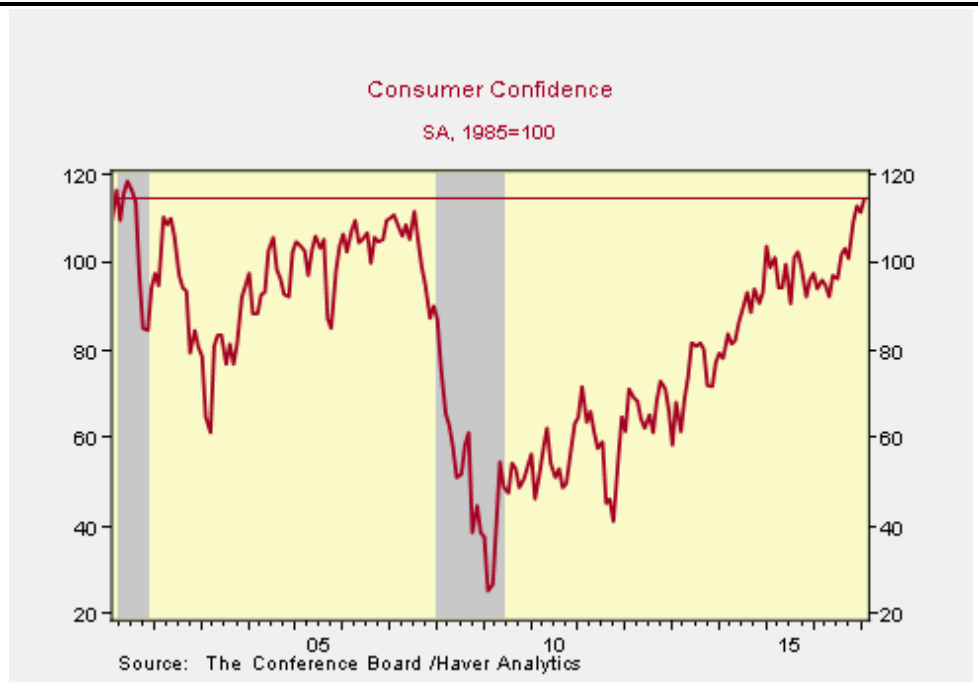
Source: Monthly data. Source: Bureau of Economic Analysis and Haver Analytics

Chart 2: Personal Saving Rate



Source: Monthly data. Source: Bureau of Economic Analysis and Haver Analytics

Chart 3: Consumer Confidence Index



Source: Monthly data. Source: The Conference Board and Haver Analytics

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