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US inflation: no Valentine's Day treats in these data

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Consumer Price Index (monthly change, %)	Jan 2023	Dec 2022	Nov 2022	Oct 2022	Sep 2022	Aug 2022	Jan NSA YoY%
All items	0.5	0.1	0.2	0.5	0.4	0.2	6.4
Ex-food/energy	0.4	0.4	0.3	0.3	0.6	0.6	5.6
• Ex-food	0.5	0.1	0.1	0.5	0.4	0.1	5.8
• Ex-energy	0.4	0.4	0.3	0.4	0.6	0.6	6.2
Energy	2	-3.1	-1.4	1.7	-1.7	-3.9	8.7
Services	0.6	0.7	0.4	0.4	0.8	0.7	7.6
Housing	0.8	0.7	0.5	0.6	0.7	0.8	8.2
Fuels & util.	1.6	0.9	-0.3	0.0	0.9	1.3	13.2
Food/beverages	0.5	0.5	0.6	0.7	0.7	0.8	9.9
• Food	0.5	0.4	0.6	0.7	0.8	0.8	10.1
Apparel	0.8	0.2	0.1	-0.2	0.0	0.3	3.1
Transportation	0.4	-1.6	-0.7	0.7	-0.4	-1.6	3.8
Medical care	-0.4	0.3	-0.4	-0.3	0.7	0.6	3.1
Recreation	0.5	0.2	0.5	0.8	0.1	0.3	4.8
Education, comm.	0.4	0.1	0.7	0.0	0.1	0.1	1.0
Other good, serv.	0.6	-0.1	0.7	0.5	0.3	0.7	6.2
Commodities	0.4	-0.7	-0.2	0.6	-0.2	-0.5	4.5

Source: Haver Analytics.

- Americans didn't get any Valentine's Day treats in their inflation data, as prices accelerated to 0.5% m/m, and core prices (ex. food and energy prices) remained too hot for comfort with a 0.4% m/m pace. While these monthly gains were in line with consensus expectations, they left the annual rates only a tick slower at 6.4% and 5.6%, respectively. Shelter prices were the main driver behind the increase, and they account for nearly 60% of the total increase in core prices over the past year. While that component will soften imminently as it picks up the lagged impact of smaller gains as leases reset this year, we're still seeing a bit too much inflation elsewhere in the services sector. The three-month annualized change in the core services ex. shelter component accelerated by a tick to 3.7% in January. Alongside the gains we saw in January payrolls and the ISM services index, that appears to cement the case for two further quarter point hikes from the Fed at its meetings in March and May.
- The headline increase was bolstered by a rebound in energy prices, and gasoline prices are averaging higher so far in February. Consumers likely won't see much relief from gasoline prices ahead, as oil prices have a floor under them due to OPEC+ production curtailments, the restocking of the SPR, and China's re-opening. Food prices also accelerated, reflecting both extreme weather conditions and avian flu impacts, as well as domestic transportation and

labor costs. That's in contrast to the levelling off we've seen in food commodity price indices, and reflects upward pressure on wages and other wholesaling and retailing costs.

- Shelter prices decelerated by a tick to a still-heated 0.7% m/m, as the owners' equivalent rent component slowed just a bit, an early sign that the index could be starting to pick up the lagged softness in new rental rates. An easing in that component will help return inflation closer to target later in the year. The Fed understands that shelter will likely be the last component to turn softer, and they are more focused on services outside of that category as a result. Core prices excluding shelter increased by 0.24%, a deceleration from the 0.41% pace seen in December, but we can't make too much of that one month swing just yet. Other core service categories that showed robust price pressures included car insurance and rentals, dental and hospital services, recreation, and daycare and internet service providers. The heavy labor cost weighting in some of these services is key to the Fed's focus on open up some slack in the jobs market and thereby allowing wage gains to continue to decelerate.
- The core reading also included a return to inflation in core goods prices, following three months of disinflation. Still, the 0.1% increase in core goods prices was tame, and left the annual rate at a subdued 1.4%. Higher prescription drug costs (+2.1% m/m) were a key factor behind that increase, adding to an increase in appliances (+1.1% m/m) and apparel. Used car prices continued to fall sharply despite the lack of inventory in that sector. A rebuilding of inventories has helped to contain goods prices, in combination with weaker demand as spending shifted towards services, but retail sector (ex. autos) inventories were cleared out a bit in the final quarter of the year.

Implications & actions

Re: Economic forecast — This report puts an end to the string of good news on the inflation front received at the end of 2022. Some of that good news was wiped away last week when BLS revisions to the seasonal factors raised the monthly changes for the fourth quarter, and today's data remains too hot for the Fed's liking. With Q1 GDP projections moving up after the January payrolls data, odds now tilt to two further quarter point hikes from the central bank.

Re: Markets — Bond yields rose slightly and the USD appreciated in the wake of the data.