TD Economics

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Data Release: No surprise in February inflation, all set for a Fed hike

- Inflation rose to 2.7% (year-on-year) in February, continuing its upward trend as the influence of lower energy prices ebbs. Prices were up a slight 0.1% month-on-month, as lower energy prices partially offset increases for food and other core items.

- Gasoline prices were 3% lower (y/y) in February, a key influence behind the 1% drop in the energy category as a whole, as prices for energy services prices (electricity and gas) rose.

- Food prices rose 0.2% month-over-month in February, their largest increase since September 2015. Food has exerted downward pressure on headline inflation since the middle of last year, but prices are now showing a bit more upward momentum, and food inflation is now flat on a year-on-year basis.

- Core prices rose an as-expected 0.2% (m/m) in February. A slight step down from January's heady 0.3% pace, but on an annualized basis, core price growth has averaged over 3% over the past three months. On a year-on-year basis core inflation was 2.2% in February.

- Core services prices (+0.3% m/m) continues to outpace core goods (-0.0% m/m), as the strong U.S. dollar keeps prices for many imported good contained.

- With a heavy weight in the index, housing has been a key factor elevating services prices. The price index for owners' equivalent rent picked up in February to 0.3% m/m. On an annual basis, inflation in owners' equivalent rent is 3.5%, a pace it has roughly maintained since November.

Key Implications

- Energy prices kept inflation low through 2015 and much of 2016, but have become a key factor in taking headline inflation higher. We expect headline inflation to top out at 2.8% in the third quarter, so we don't expect headline inflation to rise too much further from February's pace.

- Today's report is consistent with an interest rate hike by the Fed later today. On the one hand, the Fed will generally look past higher headline inflation as transitory, as the base-year effects from the rise in energy prices from the lows of early 2016 dissipate. On the other hand, the continued improvement in underlying inflation, driven in part by firming wage growth, will be interpreted by the Fed as a sign of a diminishing economic slack, and therefore confirm the need for a tightening of monetary policy.

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