Data Release: Energy prices drag down inflation, but core prices heating up

- The Consumer Price Index (CPI) fell by 0.7% m/m in January, or slightly more than the 0.6% expected dip. Year-over-year inflation turned negative for the first time since October 2009, with prices decreasing by 0.1% from January 2014.
- Core CPI, on the other hand, accelerated to 0.2%, or double the expected gain. As such, core CPI was 1.6% higher than twelve months ago – on par with the previous month's pace.
- The decline in the headline measure was, once again, largely due to energy commodities (-18.0% m/m), food (-0.2%), and core goods (-0.1%).
- On the other hand, core services inflation accelerated to 0.3% boosted by transportation services (+0.4%) and shelter (+0.3%).

Key Implications

- Today's inflation report continued to emphasize the theme that has been developing for several months now, whereby headline inflation is under pressure from external influences while core prices are supported by domestic factors.
- Key external factors consist of falling crude oil prices and the strengthening greenback, which are driving down prices of energy commodities and core goods (which are often imported). These factors are largely transitory, and whereas the dollar continued its ascent through February (implying further pressure on non-petroleum import prices), energy prices have already seen a bounce back in recent weeks.
- Moreover, prices of core services and food away from home (such as restaurants) that are more driven by domestic factors, remain supported by increased utilization of economic resources. And while wage pressures still remain subdued by historical standards, falling unemployment is likely to pressure these upward, and may manifest in stronger pricing pressures for services that are particularly labor intensive. With this in mind, we continue to expect the Fed will begin to raise rates later this year, so as to ensure that inflationary pressures remain contained.

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