New York • London • Boston • Chicago
DECISION ECONOMICS, INC.
Information for Decisions™

New York: 212 884 9440
London: 011 44 20 7814 6706
Boston: 617 994 0500
Email: decisioneconomics@pdeeco.com

Pierre Ellis

January 19, 2012

CPI: How soft?

The headline December consumer price index come in flat, a bit softer than expected (Consensus and Decision Economics: +0.1%), but with the core, ex-food-and-energy, index up an as-expected 0.1% (Consensus and Decision Economics: +0.1%).

The headline figure was pulled down by a 1.3% decline in energy prices, while food prices rose a relatively neutral 0.2%. The mild increase in the core index, meanwhile, reflected the combination of a 0.2% decline in core goods prices and a 0.3% rise in core services.

That core services rise is the biggest since July 2008, and has no obvious special factor cause. Rents (+0.3%) and owners equivalent rent (+0.2%) have firmed over time, and, together accounting for half the core services total have created a higher base for it.

That means some very resilient-price sectors like tuition and medical-care services can periodically bubble up and lift the total, assuming that the many other core-services categories are not weak as a group. This month they were not.

Of course, space-rent-type prices are not directly influenced by labor market slack or industrial capacity utilization--so that FOMC hawks will see firmness there as weakening dovish arguments that inflation risks are low.

Meanwhile, the 0.2% decline in core goods prices is hard to understand on the basis of the data provided. Durable goods prices, weighing in at a bit less than half of the total, fell just 0.1%, a decline more than accounted for just by new and used vehicle prices, which make up 60% of the group and fell 0.4%.

There is no breakout of a core non-durable goods price index, but, implicitly, that would have fallen about 0.3%. Yet, there is no culprit culprit in the decline. Apparel prices, weighted about one third in the total, slipped only 0.1%. Tobacco prices, a small but volatile item, actually rose 0.4%. Full-detail product breakdowns show no broad decline--though there was weakness in some homefurnishings categories.

All of this is probably best seen as no-change, or even a modestly positive-change, price picture for consumer goods. For services, the picture seems to have shifted decisively to the price-increase side, but with the rate highly moderate.

Of course, even inflation of 0.2% per month exceeds the Fed's comfort zone--and that zone is not arbitrary, but reflects a tradeoff between the costs of too-low inflation, mainly deflation risk, and the costs of too-high inflation, which is confusion of the signals about wants and productive possibilities that accurate prices give.

Even Fed hawks will not be hit on the head by a need to tighten because of these numbers, but will be a bit more concerned that slack in the economy has been overestimated and that broad inflation will have already moved out of the comfort zone before the pickup has been fully acknowledged.

© 2012 Decision Economics, Inc. All rights reserved. Reproduction in whole or in part without the written permission of the copyright owner is prohibited.