CPI Inflation Watch

January US CPI Inflation preview: Pre-owned disinflation

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NSA = Not Seasonally Adjusted

A "good-enough" report

The January Consumer Price Index (CPI) report should show ongoing progress on inflation. We forecast headline and core CPI rose by 0.2% m/m (0.16% unrounded) and 0.3% (0.29% unrounded) respectively. As a result, y/y headline inflation should print five-tenths lower at 2.9%, and core should print one-tenth lower at 3.8%. Additionally, our forecast implies a headline NSA index of 307.961 compared to 306.746 in December. (See Exhibit 1 for our detailed forecast table)

Components back in the spotlight

The Fed emphasized that it would need to see "greater confidence" in the inflation data to begin its cutting cycle. We think part of the confidence the Fed is looking for is in the composition of disinflation (see: January FOMC: March is no longer the base case). To date, disinflation has been driven more by goods price deflation, while services disinflation has been more stubborn. We expect this divergence to persist in January as we forecast core goods prices fell by 0.3% m/m, but core service increased by 0.5% m/m. That said, the Fed was likely somewhat encouraged by the revisions to CPI which resulted in faster disinflation in core services in 4Q and less deflation for core goods.

Small items pack a big punch

A few volatile items—used cars, transportation services and lodging away from home—are one reason for the divergence between our January core goods and core services forecasts. We expect used car prices fell by 1.8% m/m in January given declines in wholesale prices and retracing the increases seen in November and December. Excluding used cars, core goods likely fell by a more modest 0.1% m/m. Meanwhile, services are likely to be boosted by larger price increases in transportation services and lodging away from home this month as demand for travel started the year on a strong note.

CPI inflation is all about shelter

In addition to the few volatile items, shelter is the other reason that core services inflation has remained stickier. Excluding shelter, core CPI should print at a more modest 0.15% m/m. The good news is that we expect shelter inflation to moderate over the course of the year given the disinflation seen in asking rent inflation (See: US Viewpoint: Rent inflation to moderate but regional differences persist)

Implications for our monetary policy views

A report in line with our expectations would continue to build the Fed's confidence and support our expectation for the first cut to be in June. The details of our forecast suggest that January PCE inflation, the Fed's preferred measure, could come in softer than CPI again given the difference in weights for housing services. That said, strong PCE financial services inflation may bias the print higher in January. Nevertheless, this is just the first of five CPI reports the Fed will have on hand at its June meeting. Therefore, the outcome of the January report is unlikely to meaningfully shift our expectations for monetary policy.

Exhibit 1: CPI detailed forecast table
Below is our detailed CPI forecast for January

	% m/m		% y/y (SA)	3-month % ch. annualized	
	January Forecast	Previous month	Previous month	January Forecast	Previous month
Headline NSA Index (level)	**307.961**	**306.746**			
Core NSA Index (level)	313.313	311.907			
Headline CPI (All Items)	**0.16%**	**0.23%**	**3.3%**	**1.6%**	**1.9%**
Food	0.2%	0.2%			
Energy	-1.5%	-0.2%			
Core CPI	**0.29%**	**0.28%**	**3.9%**	**3.5%**	**3.3%**
Core goods	**-0.27%**	**-0.06%**	**0.1%**	**-2.2%**	**-1.2%**
Household furnishings and supplies	0.0%	-0.3%			
Apparel	0.0%	0.0%			
Transportation commodities less motor fuel	-0.6%	0.3%			
Of which:					
New vehicles	0.0%	0.2%			
Used cars and trucks	-1.8%	0.6%			
Medical care commodities	0.3%	-0.1%			
Recreation commodities	-0.5%	-0.5%			
Other recreational goods	-0.5%	-0.5%			
Education and communication commodities	-0.5%	-0.2%			
Alcoholic beverages	0.2%	0.1%			
Other goods	0.2%	-0.5%			
Core Services	**0.46%**	**0.38%**	**5.3%**	**5.3%**	**4.8%**
Shelter	0.4%	0.4%			
Of which:					
Rent	0.4%	0.4%			
Lodging away from home	0.5%	0.2%			
OER	0.4%	0.4%			
Water and sewer	0.3%	0.1%			
Medical care services	0.4%	0.5%			
Of which:					
Health insurance	1.1%	1.1%			
Transportation services	1.1%	0.1%			
Of which:					
Airfares	1.1%	0.9%			
Recreation services	0.5%	1.1%			
Education and communication	0.3%	0.2%			
Other personal services	0.2%	0.1%			
Additional aggregate (Calculated by BofA Global Research)					
Core services ex rent and OER	**0.5%**	**0.3%**	**3.9%**	**5.4%**	**4.0%**

Source: BofA Global Research, Bureau of Labor Statistics, Haver Analytics

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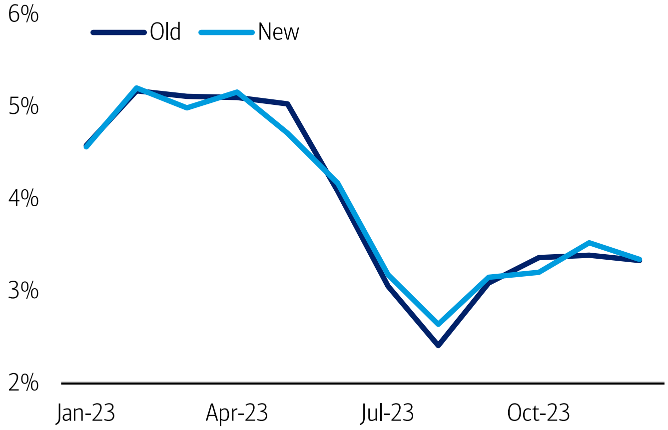
New seasonal factors do not materially change the story

Despite the fanfare, last week's revisions to CPI were somewhat of a nonevent, consistent with our expectations (See: CPI Inflation Watch: CPI revisions unlikely to impact Fed policy). The revisions became a focus for market participants after Governor Christopher Waller indicated he would be paying close attention to the revised data. The good news is that, unlike last year, this year's did not materially alter the path and progress seen on inflation was largely unchanged (Exhibit 2 and Exhibit 3). Indeed, the 3- and 6-month annualized rate for core CPI inflation in December was revised up by 1bp and 4bp, respectively.

Exhibit 2: Core CPI pre-and-post revisions (3-m annual % ch.)
This year's CPI revisions did not materially change the path of inflation



Source: Bureau of Labor Statistics, Haver Analytics
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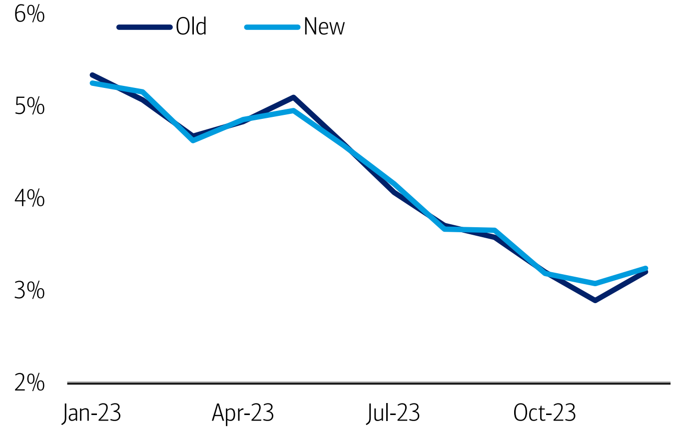
Exhibit 3: Core CPI pre-and-post revisions (6-m annual % ch.)
This year's CPI revisions did not materially change the path of inflation



Source: Bureau of Labor Statistics, Haver Analytics
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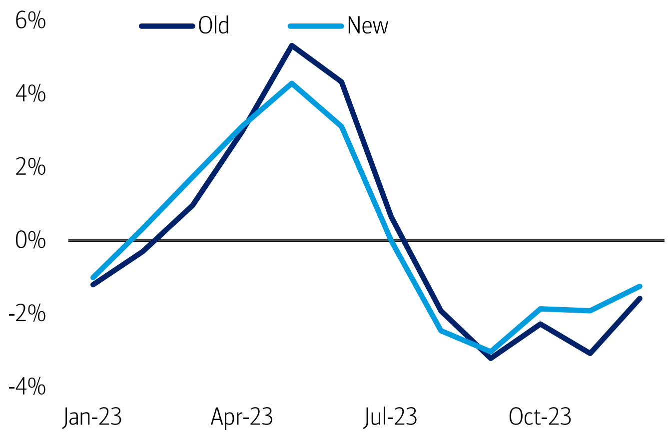
Underneath the hood the revisions did lead to some meaningful shifts. First, the revisions resulted in more modest deflation in core goods to end the year (Exhibit 4). This appears to be due in part to upward revisions to used vehicle prices and apparel (Exhibit 6). Second, core services inflation was revised slightly lower to close the year owing in part to downward revisions in rent, OER and medical services (Exhibit 5). We think this is marginally good news for the Fed as the disinflation seen towards the end of last year was less about goods deflation than originally thought.

Exhibit 4: Core goods CPI pre-and-post revisions (3-m annual % ch.)
The revisions revised away some of the deflation at the end of the year



Source: Bureau of Labor Statistics, Haver Analytics
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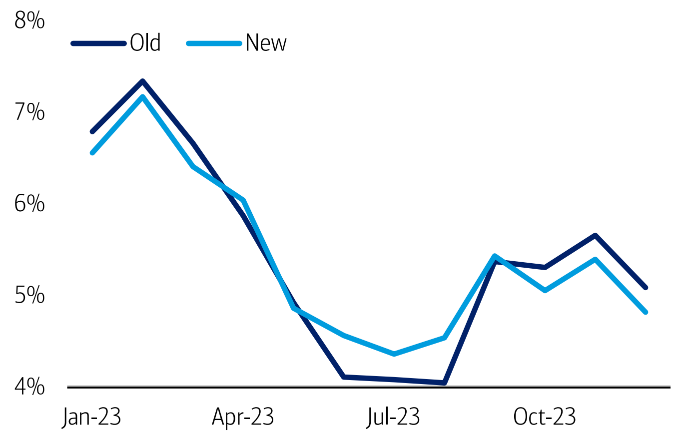
Exhibit 5: Core services CPI pre-and-post revisions (3-m annual % ch.)
The revisions revised down services inflation to end the year



Source: Bureau of Labor Statistics, Haver Analytics
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The revisions, however, are not all rosy for the inflation outlook. Looking at the monthly details, the new seasonal factors will be more of a boost to core inflation in four of the first six months of the year. Therefore, progress on inflation might be a little harder to come by in the first half of the year.

Exhibit 6: The change in the % m/m inflation rate for headline and various categories of CPI (bps)

Revisions to inflation were relatively modest to end the year but there were several components which saw large revisions throughout the year

	Headline	Core	Core goods	Apparel	New Vehicles	Used vehicles	Alcoholic beverages	Core Services	Shelter	Rent	OER	Medical care services	Transportation services
Jan	0.0	1.5	3.0	-39.6	-0.3	59.7	8.5	1.7	-1.5	-3.0	-1.2	24.3	2.3
Feb	1.4	1.6	14.6	-21.0	3.4	134.7	10.5	-0.7	-3.7	1.0	-1.5	19.9	-7.3
Mar	2.5	-6.0	1.5	-3.6	-6.8	29.4	-2.5	-7.0	-3.2	0.0	1.8	-0.6	-49.4
Apr	5.9	5.9	-12.7	-0.6	7.5	-121.6	-5.5	11.7	6.2	2.1	2.4	7.9	69.3
May	-1.4	-7.4	-13.5	-9.2	3.5	-122.8	-5.5	-6.1	-1.7	3.1	0.6	0.1	-57.7
Jun	3.0	3.7	-3.2	-16.6	-1.5	-14.9	4.7	5.4	4.9	1.9	2.0	-3.2	31.0
Jul	3.9	6.8	0.5	16.2	4.7	-12.9	8.4	7.4	3.8	5.4	1.1	8.3	48.0
Aug	-11.9	-4.8	-11.1	-5.0	-5.5	-62.9	-1.0	-1.0	6.1	-0.1	4.5	-10.0	-34.6
Sep	-3.6	-0.4	15.3	41.0	-5.3	73.6	-21.2	-5.0	-7.7	-3.0	-5.9	-7.2	3.6
Oct	3.4	1.4	6.4	-8.9	2.5	39.4	14.4	-0.1	0.7	-3.0	0.9	-11.6	6.0
Nov	6.3	2.3	8.1	65.4	4.7	-21.1	5.8	-1.2	-0.2	-3.7	-1.2	-10.6	-3.8
Dec	-7.0	-3.4	-6.1	-10.5	-8.9	10.7	-17.8	-5.1	-4.9	-2.5	-4.8	-20.8	-2.3

Source: Bureau of Labor Statistics, Haver Analytics

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New weights: higher shelter, lower vehicles

In addition to the revised seasonal factors, the weights of the CPI basket were also updated to incorporate data from the 2022 consumer expenditure survey. Recall, that last year the Bureau of Labor Statistics shifted to updating the weights on an annual basis rather than a bi-annual basis.

In Exhibit 9 we show the changes in weights to the major expenditure categories of CPI inflation. The weight of core goods fell by 1.9ppt owing to a drop in motor vehicle and parts, and household furnishings and supplies. Meanwhile, the weight of core services increased by 1.8ppt due largely to higher weights for rent and OER.

Exhibit 9: Comparison of new weights for the CPI basket (%)

The weight of core goods declined, and the weight of core services increased.

	Annual update	Nov-23	Change
Food	13.6	13.4	0.1
Energy	6.7	6.7	-0.1
Core CPI	79.8	79.8	0.0
Core goods	18.9	20.8	-1.9
Household Furnishings and Supplies	3.5	4.2	-0.7
Apparel	2.5	2.5	0.0
Motor Vehicles & Parts	6.2	7.5	-1.2
New Vehicles	3.7	4.2	-0.5
Used Cars and Trucks	2.0	2.5	-0.5
Medical Care Commodities	1.5	1.5	0.0
Recreation Commodities	2.0	2.2	-0.2
Education and Communication Commodities	0.9	0.8	0.0
Alcoholic Beverages	0.9	0.8	0.0
Other Goods	1.4	1.3	0.1
Core services	60.9	59.1	1.8
Shelter	36.2	35.2	1.0
Rent of Primary Residence	7.7	7.7	0.0
Lodging Away From Home	1.3	1.1	0.3
Owners' Equivalent Rent of Residences	26.8	26.0	0.8
Water & Sewer & Trash Collection Services	1.1	1.1	0.0
Household Operations	1.0	0.9	0.1
Medical Care Services	6.5	6.4	0.1
Transportation Services	6.3	6.1	0.2
Recreation Services	3.3	3.1	0.1
Education and Communication Services	5.0	4.8	0.2
Other Personal Services	1.5	1.5	0.1

Source: BofA Global Research, Bureau of Labor Statistics, Haver Analytics

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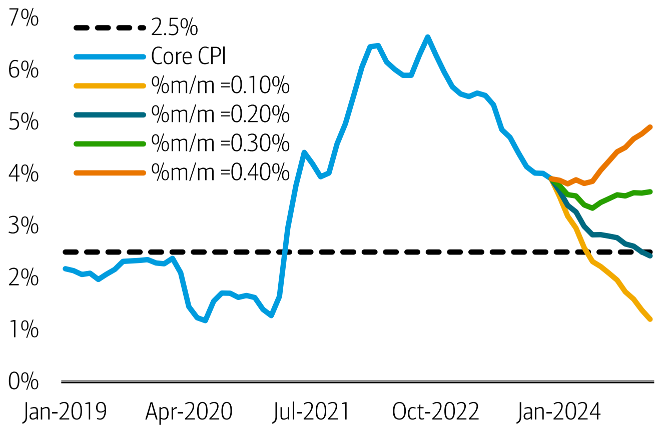
To see the effect of the weights, we calculate the % m/m and % y/y inflation weight for core CPI using the old weights and compare them to the actual data. Using the old weights, inflation in December would have been 1bp lower on a month-over-month basis and little changed on a y/y basis. In short, the new weights did not alter the path of inflation materially either.

Simple simulations

With 2023 behind us, we look ahead to 2024 and refresh our simple simulations of core CPI and PCE y/y inflation. These simulations are a useful illustration of how favorable base effects should likely result further declines in y/y inflation. For example, if both measures of core CPI print at 0.3% m/m over the next three prints then the y/y rate for both will fall by three-tenths. If core PCE instead prints at 0.2% m/m, which is not unreasonable given its averaged 0.15% m/m over the last six months, then the y/y rate would fall by six-tenths to 2.3% in March. In short, the 12-month measures of inflation are likely to give the Fed more confidence that inflation is on track towards its target.

Exhibit 8: Core CPI simulations (% y/y SA)
Core CPI is likely to continue falling on a y/y basis in the near-term



Source: Bureau of Labor Statistics, Haver Analytics

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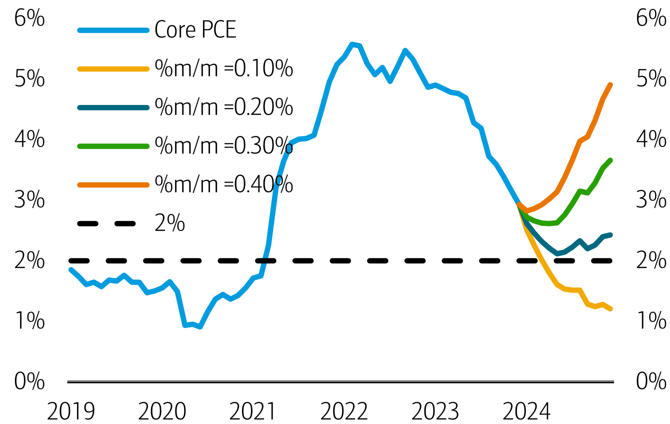
Exhibit 9: Core PCE simulation (% y/y SA)
Base effects are more positive for core PCE inflation in the near-term



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