

## US Watch

## February CPI inflation: About as expected

## Key takeaways

- Headline CPI rose by 0.4% m/m, in line with expectations. Core CPI rounded up to 0.5% m/m, topping consensus expectations.
- Core services inflation remained sticky at 0.6% m/m and is at levels that are inconsistent with the Fed's 2% target.
- We maintain our call for a 25bp hike in March and for a terminal rate of 5.25-5.50% by June.

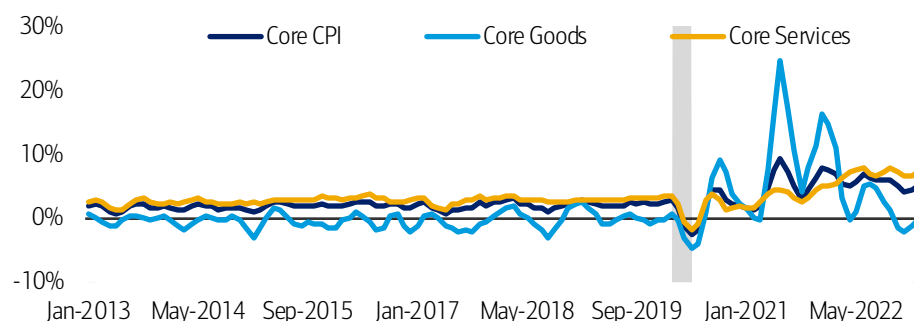
## Services still a sticky problem

The February CPI report was roughly in line with expectations. Headline CPI rose by 0.4% m/m (+0.37% unrounded, BofA: +0.38% m/m). As a result, the y/y rate fell from 6.4% to 6.0%, and the NSA index came in at 300.840 (BofA: 300.893). Core CPI inflation, meanwhile, rounded up to 0.5% m/m (+0.45% unrounded; Consensus: 0.4%; BofA: 0.42% m/m), but the y/y rate ticked down a tenth to 5.5% as expected. Over the last three months core CPI has increased at a 5.2% annualized rate, its highest reading since October 2022 as underlying inflation remains well above the Fed's target (Exhibit 1)

In our view, the report continues to illustrate the sticky inflation problem the Fed is currently facing. Given the Fed's focus on core services ex housing services, it will not be encouraged by core services ex rent and OER advancing by 0.5% m/m in February. Financial markets have increased uncertainty about the near-term policy outlook; however, today's report supports our view for a 25bp hike in March.

**Exhibit 1: Core CPI and its major components (3-month annualized change)**

Core services inflation remains sticky-high leading to high core CPI inflation



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

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14 March 2023

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## Glossary

CPI = Consumer Price Index

PPI = Producer Price Index

PCE = Personal Consumption Expenditures (Price Index)

OER = Owners' Equivalent Rent

NSA = Not Seasonally Adjusted

OIS- Overnight Indexed Swap

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Timestamp: 14 March 2023 10:58AM EDT

## The details

Beginning with the noncore components, food prices rose by 0.4% m/m modestly below our expectation for a 0.5% m/m increase. This marks a slight deceleration from the 0.5% m/m average seen over the prior three months. The slowdown was largely due to food at home inflation declining from 0.42% m/m in January to 0.25% m/m in February. Falling commodity prices and transportation costs are likely contributing to easing food at home inflation. However, food away from home inflation was little changed at 0.63% m/m (NSA) likely owing in part to wage costs pressures.

Energy prices meanwhile fell by 0.6% m/m, which was a larger decline than we expected (0.4% m/m). That said, the drop in energy prices was driven by a 1.7% m/m decline in energy services as prices partially retraced in the West, which offset a modest 0.5% m/m increase in energy goods.

Turning to core, the 0.45% m/m increase was driven entirely by services inflation. Core services rose by 0.62% m/m, which was 8bps above our forecast. Shelter inflation (+0.8% m/m) was once again the key driver of core services and core inflation overall. The category contributed 33bp to the 45bp increase in core inflation. OER and rent inflation remained sticky-high as both increased modestly from the January readings. Meanwhile, lodging away from home increased by 2.3% m/m and the index is now close to 14% above February 2020 levels. This likely reflects rising labor costs being passed through to consumers and strong demand for travel and leisure services.

Excluding rent and OER from core services, prices rose by 0.5% m/m according to Haver Analytics, accelerating from the 0.4% m/m pace in January. Over the last three months, the index has risen by 5.2% annualized, which is well above pre-pandemic levels and inconsistent with the Fed's 2% target. Within the category, transportation services rose by 1.1% m/m supported by a 6.4% m/m jump in airfares and a 1.6% m/m (NSA) increase in motor vehicle insurance. The rise in airfares was much stronger than we expected (+1.0% m/m). Meanwhile, we expect motor vehicle insurance will continue to rise at a rapid clip in the near-term. Recreation services also rose by 1.2% m/m as broad-based increases in pet services, video and audio services, and admissions pushed the category higher. Medical care services prices did fall again (-0.7% m/m) providing some offset to the other categories; however, the decline continues to reflect lagged data used to estimate health insurance.

While core services remained sticky, core goods prices were unchanged in February (-0.01% m/m). The flat reading on core goods reflected a 2.8% m/m drop in used car prices, well below our expectation for a 0.5% m/m decline. Outside of used cars, there are few signs of goods price deflation. Indeed, core goods ex used cars rose by 0.4% m/m and has accelerated over the last three months. Apparel and household furnishings inflation remained elevated in February. We have been expecting both to moderate or decline modestly given the ongoing improvement in supply chains and better inventory-to-sales ratios. However, we have yet to truly see those factors take hold.

## Fed: We maintain our policy outlook

In our view, the report supports our outlook for the Fed to hike by 25bp in March and continue to hike rates to a terminal of 5.25-5.50% in June. Services inflation remains inconsistent with the Fed's two percent target, and while there is increased uncertainty due to the recent news in the banking sector, the Fed still needs to do more to cool off the economy and labor market.

## GDP implications: 1 Q tracking unchanged

The February CPI print was in line with consensus expectations and ours. We use the CPI data as deflators in our PCE estimate. Today's print left our 1Q US GDP tracking estimate unchanged at 0.7% q/q saar.

## Rates strategy view

CPI affirmed the partial retracement at the front-end of the UST curve this morning, with the market now pricing almost a full 25bps hike in March and 17bps of a hike in May. The data as of February endorses the view that there is likely more for the Fed to tighten despite recent banking sector stress. The market path still remains well below our US Econ team's view for three more 25-bps hikes, with the market pricing some probability of cuts in June. The curve continued flattening following the data with both breakevens and real rates higher at the front-end vs back-end of the curve. Should bank contagion stress be more limited, today's CPI data points to very strong cyclical components of inflation, a key focus of the Fed, despite moderation in goods inflation. Should the Fed prioritize concern over financial stability risks vs still strong inflation, we see room for breakevens to move higher at longer-dated tenors.



**Exhibit 4: CPI Forecast vs. Actual (SA % m/m unless specified otherwise)**

Below is a table that compares our bottoms-up CPI forecasts to actuals

	February Forecast		
	Actual	Forecast	Error
<b>NSA Index (level)</b>	<b>300.840</b>	<b>300.893</b>	<b>-0.053</b>
<b>Headline CPI (All Items)</b>	<b>0.37%</b>	<b>0.38%</b>	<b>-0.01%</b>
Food	0.4%	0.5%	-0.1%
Energy	-0.6%	-0.4%	-0.2%
<b>Core CPI</b>	<b>0.45%</b>	<b>0.42%</b>	<b>0.03%</b>
<b>Core goods</b>	<b>-0.01%</b>	<b>0.10%</b>	<b>-0.11%</b>
Household furnishings and supplies	0.8%	0.2%	0.6%
Apparel	0.8%	0.2%	0.6%
Transportation commodities less motor fuel	-0.9%	-0.1%	-0.8%
<i>Of which:</i>			
New vehicles	0.2%	0.2%	0.0%
Used cars and trucks	-2.8%	-0.5%	-2.3%
Medical care commodities	0.1%	0.5%	-0.3%
Recreation commodities	0.4%	0.0%	0.5%
Other recreational goods	1.2%	-0.4%	1.6%
Education and communication commodities	-0.8%	-0.1%	-0.7%
Alcoholic beverages	-0.3%	0.6%	-0.8%
Other goods	0.7%	0.4%	0.3%
<b>Core Services</b>	<b>0.62%</b>	<b>0.54%</b>	<b>0.08%</b>
Shelter	0.8%	0.7%	0.1%
<i>Of which:</i>			
Rent	0.7%	0.7%	0.0%
Lodging away from home	2.3%	0.8%	1.5%
OER	0.7%	0.7%	0.0%
Water and sewer	0.8%	0.5%	0.3%
Medical care services	-0.7%	-0.3%	-0.4%
<i>Of which:</i>			
Health insurance	-4.1%	-3.8%	-0.3%
Transportation services	1.1%	0.8%	0.4%
<i>Of which:</i>			
Airfares	6.4%	1.0%	5.4%
Recreation services	1.2%	0.7%	0.5%
Education and communication	0.2%	0.4%	-0.2%
Other personal services	1.1%	0.4%	0.7%

Source: BofA Global Research, Bureau of Labor Statistics, Bloomberg

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**Exhibit 5: CPI heatmap (%m/m)**

Headline CPI rose by 0.4% m/m in February

Jan-23 weight	Component	Feb-23	Jan-23	Dec-22	Nov-22	Oct-22	Sep-22	Aug-22	Jul-22	Jun-22	May-22	Apr-22	Mar-22
<b>100.0</b>	<b>Headline CPI</b>	<b>0.37%</b>	<b>0.52%</b>	<b>0.13%</b>	<b>0.21%</b>	<b>0.49%</b>	<b>0.41%</b>	<b>0.23%</b>	<b>-0.03%</b>	<b>1.19%</b>	<b>0.92%</b>	<b>0.40%</b>	<b>1.01%</b>
13.5	Food	0.39%	0.51%	0.45%	0.55%	0.68%	0.78%	0.83%	1.08%	1.00%	1.10%	0.81%	0.92%
7.1	Energy	-0.56%	1.97%	-3.06%	-1.41%	1.68%	-1.74%	-3.89%	-4.70%	6.89%	3.36%	-0.97%	8.16%
<b>79.4</b>	<b>Core CPI</b>	<b>0.45%</b>	<b>0.41%</b>	<b>0.40%</b>	<b>0.31%</b>	<b>0.33%</b>	<b>0.57%</b>	<b>0.58%</b>	<b>0.31%</b>	<b>0.60%</b>	<b>0.63%</b>	<b>0.47%</b>	<b>0.31%</b>
4.4	Household Furnishings and Supplies	0.76%	0.51%	0.25%	0.36%	0.04%	0.48%	0.88%	0.62%	0.55%	0.24%	0.57%	0.89%
2.5	Apparel	0.81%	0.83%	0.21%	0.10%	-0.25%	0.04%	0.28%	-0.12%	0.70%	0.45%	-0.14%	0.31%
7.6	Motor Vehicles & parts	-0.90%	-0.71%	-0.62%	-0.66%	-0.50%	-0.16%	0.37%	-0.14%	0.53%	1.24%	-0.04%	-1.68%
4.3	New Vehicles	0.18%	0.23%	0.58%	0.47%	0.56%	0.67%	0.84%	0.47%	0.52%	0.60%	0.45%	0.10%
2.6	Used Cars and Trucks	-2.77%	-1.94%	-1.99%	-1.99%	-1.71%	-1.10%	-0.18%	-0.82%	0.52%	1.86%	-0.68%	-3.59%
1.5	Medical Care Commodities	0.15%	1.06%	0.11%	0.19%	-0.02%	-0.09%	0.24%	0.59%	0.39%	0.25%	0.06%	0.20%
2.3	Recreation Commodities	0.44%	0.12%	0.09%	-0.34%	0.78%	-0.05%	0.64%	0.15%	0.39%	0.11%	0.53%	-0.05%
0.9	Education and Communication Commodities	-0.77%	-0.09%	-0.92%	-1.69%	-1.53%	-0.53%	-0.40%	-0.46%	0.18%	-1.71%	-2.23%	-0.83%
0.8	Alcoholic Beverages	-0.28%	0.41%	0.65%	0.64%	0.69%	0.31%	0.36%	0.43%	0.35%	0.38%	0.36%	0.52%
1.2	Other Goods	0.74%	0.77%	-0.07%	0.62%	0.58%	0.39%	1.15%	0.34%	0.50%	0.80%	0.34%	0.58%
34.4	Shelter	<b>0.76%</b>	<b>0.74%</b>	<b>0.79%</b>	<b>0.64%</b>	<b>0.72%</b>	<b>0.74%</b>	<b>0.67%</b>	<b>0.57%</b>	<b>0.58%</b>	<b>0.62%</b>	<b>0.50%</b>	<b>0.50%</b>
25.4	Owners' Equivalent Rent of Residences	0.70%	0.67%	0.79%	0.65%	0.62%	0.79%	0.69%	0.63%	0.67%	0.59%	0.47%	0.46%
7.5	Rent of Primary Residence	0.76%	0.74%	0.79%	0.77%	0.72%	0.81%	0.74%	0.70%	0.76%	0.62%	0.57%	0.44%
1.1	Lodging Away From Home	2.26%	1.20%	1.10%	-0.52%	3.49%	-0.51%	-0.09%	-1.74%	-3.09%	1.70%	0.72%	2.17%
1.1	Water & Sewer & Trash Collection Services	0.79%	0.85%	0.25%	0.31%	0.17%	0.79%	0.49%	0.35%	0.40%	0.29%	0.32%	0.13%
0.9	Household Operations	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	0.14%	2.08%	#N/A	#N/A
6.6	Medical Care Services	-0.70%	-0.68%	0.30%	-0.49%	-0.38%	0.83%	0.68%	0.39%	0.65%	0.44%	0.49%	0.60%
5.8	Transportation Services	1.14%	0.85%	0.63%	0.33%	0.60%	1.91%	0.99%	-0.40%	1.80%	1.55%	2.25%	2.06%
0.6	Airline Fares	6.38%	-2.15%	-2.05%	-1.63%	-1.16%	0.44%	-1.53%	-8.39%	-1.98%	11.14%	15.70%	11.77%
3.1	Recreation Services	1.19%	0.73%	0.29%	0.94%	0.78%	0.19%	0.03%	0.50%	0.32%	0.50%	0.33%	0.36%
4.9	Education and Communication Services	0.21%	0.45%	0.26%	0.98%	0.17%	0.17%	0.21%	-0.04%	0.12%	0.18%	0.19%	-0.08%
1.4	Other Personal Services	1.06%	0.54%	-0.15%	0.82%	0.36%	0.27%	0.30%	0.40%	0.43%	0.12%	0.51%	0.43%

Source: BofA Global Research, Bureau of Labor Statistics

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**Exhibit 6: CPI heatmap (%y/y)**

Headline CPI fell to 6.0% y/y in February

Jan-23 weight	Component	Feb-23	Jan-23	Dec-22	Nov-22	Oct-22	Sep-22	Aug-22	Jul-22	Jun-22	May-22	Apr-22	Mar-22
<b>100.0</b>	<b>Headline CPI</b>	<b>6.04%</b>	<b>6.41%</b>	<b>6.45%</b>	<b>7.11%</b>	<b>7.75%</b>	<b>8.20%</b>	<b>8.26%</b>	<b>8.52%</b>	<b>9.06%</b>	<b>8.58%</b>	<b>8.26%</b>	<b>8.54%</b>
13.5	Food	9.49%	10.13%	10.41%	10.63%	10.95%	11.24%	11.37%	10.93%	10.44%	10.15%	9.38%	8.80%
7.1	Energy	5.19%	8.70%	7.31%	13.07%	17.63%	19.79%	23.81%	32.93%	41.62%	34.60%	30.27%	32.05%
<b>79.4</b>	<b>Core CPI</b>	<b>5.54%</b>	<b>5.58%</b>	<b>5.71%</b>	<b>5.96%</b>	<b>6.28%</b>	<b>6.63%</b>	<b>6.32%</b>	<b>5.91%</b>	<b>5.92%</b>	<b>6.02%</b>	<b>6.16%</b>	<b>6.47%</b>
4.4	Household Furnishings and Supplies	6.33%	6.37%	7.28%	8.28%	8.81%	9.90%	10.60%	10.78%	10.17%	9.71%	10.63%	10.85%
2.5	Apparel	3.26%	3.06%	2.91%	3.55%	4.09%	5.46%	5.06%	5.13%	5.23%	4.98%	5.36%	6.77%
7.6	Motor Vehicles & Parts	-3.18%	-2.26%	-0.95%	2.37%	5.48%	8.40%	9.10%	8.80%	9.55%	14.14%	17.21%	21.76%
4.3	New Vehicles	5.83%	5.78%	5.89%	7.20%	8.39%	9.40%	10.05%	10.44%	11.43%	12.62%	13.21%	12.55%
2.6	Used Cars and Trucks	-13.58%	-11.62%	-8.83%	-3.34%	2.03%	7.18%	7.78%	6.61%	7.10%	16.06%	22.73%	35.32%
1.5	Medical Care Commodities	3.19%	3.39%	3.21%	3.13%	3.06%	3.67%	4.09%	3.65%	3.22%	2.41%	2.13%	2.66%
2.3	Recreation Commodities	2.85%	3.27%	4.11%	3.63%	4.31%	4.05%	3.84%	4.12%	4.47%	3.77%	4.03%	4.70%
0.9	Education and Communication Commodities	-10.47%	-10.26%	-10.08%	-9.68%	-9.08%	-8.32%	-7.33%	-6.99%	-5.71%	-6.03%	-4.01%	1.32%
0.8	Alcoholic Beverages	4.92%	5.82%	5.78%	5.54%	5.01%	4.09%	4.28%	4.22%	4.04%	4.04%	3.87%	3.72%
1.2	Other Goods	6.96%	7.15%	7.17%	7.51%	7.21%	7.90%	7.57%	6.73%	6.57%	6.16%	5.17%	5.28%
34.4	Shelter	<b>8.10%</b>	<b>7.88%</b>	<b>7.51%</b>	<b>7.12%</b>	<b>6.92%</b>	<b>6.59%</b>	<b>6.24%</b>	<b>5.69%</b>	<b>5.61%</b>	<b>5.45%</b>	<b>5.14%</b>	<b>5.00%</b>
25.4	Owners' Equivalent Rent of Residences	8.01%	7.76%	7.53%	7.13%	6.89%	6.68%	6.29%	5.83%	5.48%	5.09%	4.79%	4.54%
7.5	Rent of Primary Residence	8.76%	8.56%	8.35%	7.91%	7.52%	7.21%	6.74%	6.31%	5.78%	5.22%	4.82%	4.44%
1.1	Lodging Away From Home	6.73%	7.69%	3.18%	3.24%	5.86%	2.91%	4.03%	1.04%	10.00%	19.27%	19.66%	25.09%
1.1	Water & Sewer & Trash Collection Services	5.25%	4.97%	4.94%	5.01%	4.77%	4.93%	4.63%	4.35%	4.43%	4.35%	4.18%	4.02%
0.9	Household Operations	#N/A	#N/A	#N/A	#N/A	6.57%	#N/A	6.61%	#N/A	6.49%	5.34%	6.43%	#N/A
6.6	Medical Care Services	2.15%	2.99%	4.12%	4.38%	5.45%	6.51%	5.65%	5.09%	4.82%	4.02%	3.47%	2.90%
5.8	Transportation Services	14.64%	14.63%	14.58%	14.19%	15.19%	14.60%	11.32%	9.15%	8.83%	7.93%	8.46%	7.69%
0.6	Airline Fares	26.54%	25.56%	29.14%	35.90%	43.02%	42.64%	33.70%	26.60%	33.56%	37.59%	33.48%	24.57%
3.1	Recreation Services	6.34%	5.75%	5.71%	5.38%	3.94%	4.06%	4.24%	4.53%	4.72%	4.86%	4.42%	4.78%
4.9	Education and Communication Services	2.86%	2.77%	2.41%	2.24%	1.32%	1.36%	1.53%	1.52%	1.69%	1.68%	1.67%	1.64%
1.4	Other Personal Services	5.21%	5.34%	5.55%	6.49%	5.76%	5.93%	5.77%	5.91%	6.73%	6.46%	6.19%	5.67%

Source: BofA Global Research, Bureau of Labor Statistics

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