The US Inflation Trend Chartbook

CapitalSpectator.com

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James Picerno, editor
+1.732.710.4750
caps@CapitalSpectator.com

Inflation Picks Up In January, Fueling More Uncertainty About The Outlook For Fed Policy

Consumer price inflation surprised to the upside for the January report, raising more doubt about the Federal Reserve's ability to leave monetary policy unchanged for the near term. Headline CPI ticked up to a 3.0% year-over-year rate through last month, the highest since last June (p. 2). The 1-year pace for headline CPI has now increased for four straight months.

CPI and PCE Inflation: 1-year % change

Date	CPI:Headline	CPI:Core	PCE:Headline	PCE:Core
Nov 2024	2.7	3.3	2.4	2.8
Dec 2024	2.9	3.2	2.6	2.8
Jan 2025	3.0	3.3		

Core CPI also ticked higher, although this measure of inflation remains range-bound. Core CPI, a more robust measure of the trend vs. headline CPI, rose 3.3% in January vs. the year-ago level (p. 2). Core CPI's 1-year change has been in a holding pattern in the low-3% range since the summer, but remains well above the Fed's 2% target, which implies that the central bank has more work to do to tame the so-called last mile of the pandemic-related inflation surge. Nonetheless, the relatively steady rate of core CPI for one-year changes, despite the latest uptick, suggests that sticky inflation has yet to transform into a new period of rising inflation. Unfortunately, it's also telling us that the previous progress on taming inflation remains stalled.

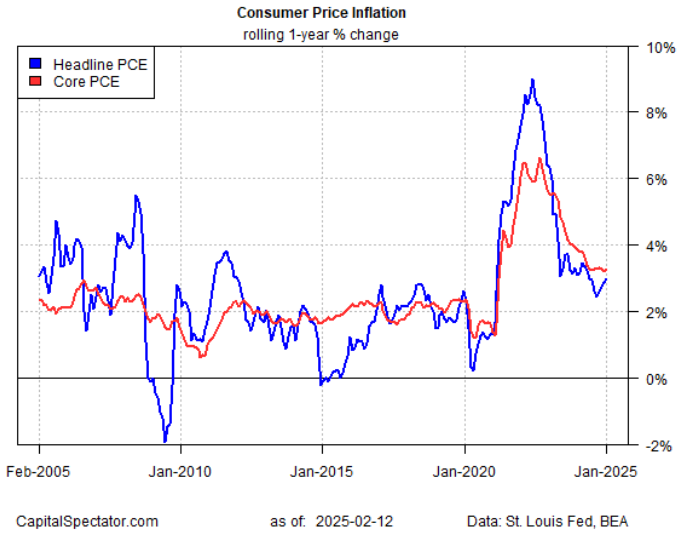
Several alternative inflation metrics are starting to look worrisome. Our proprietary measure of the bias for consumer prices rose for a fourth straight month (p. 3). This indicator is calculated with several conventional and alternative inflation benchmarks and so it tends to be relatively robust tool for capturing the trend. Additional concern is related to the recent upward moves in inflation expectations, based on models and markets (p. 4). Another possible warning sign: the inflation expectation bias for several forward time periods has increased for four straight months (p. 9).

Fortunately, there are still some relatively upbeat metrics to cite. Our consumer inflation pulse index has pulled back recently after running higher (p. 8). The implication: the recent firming of pricing pressure is starting to ease. Also, the spread in headline CPI less core CPI remains moderately negative, which suggests there's still a headwind for inflation rising much higher from current levels (p. 8).

A major wildcard is still Trump 2.0 and the president's plans for import tariffs. Although an across-the-board 25% tariff on imports from Mexico, Canada and China was put on pause, the White House decided to move ahead with a 10% tariff on China. In addition, earlier this week Trump announced 25% tariffs on all steel and aluminum imports. It's unclear what the president is planning for tariffs going forward. What is clear is that tariffs tend to boost inflation, if only temporarily. The problem is that in the current climate the potential for another source of inflationary pressure for the US is ill-timed.

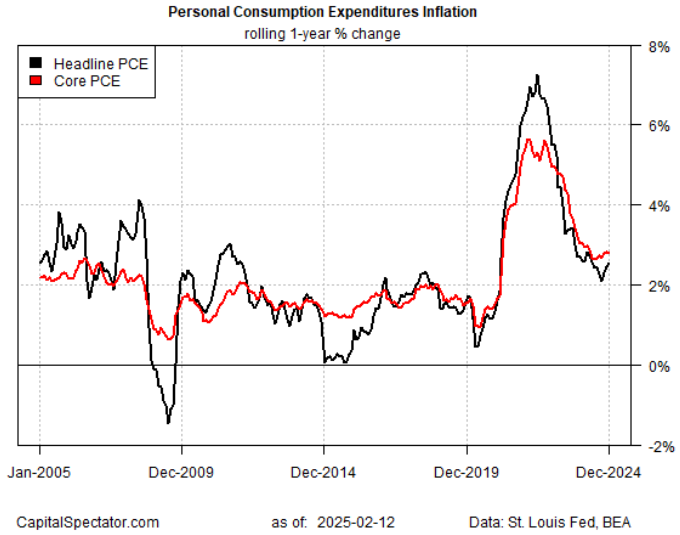
The Federal Reserve is still expected to leave its target rate unchanged at the next policy meeting on March 19, based on Fed funds futures. Note, however, that the February report on consumer inflation is scheduled for release on March 12, a week ahead of the FOMC meeting. Rest assured that the next CPI report will be widely read for deciding if sticky-inflation risk is turning into something more problematic for the Fed.

Headline/Core Consumer Price Indexes: 1-Year Trend



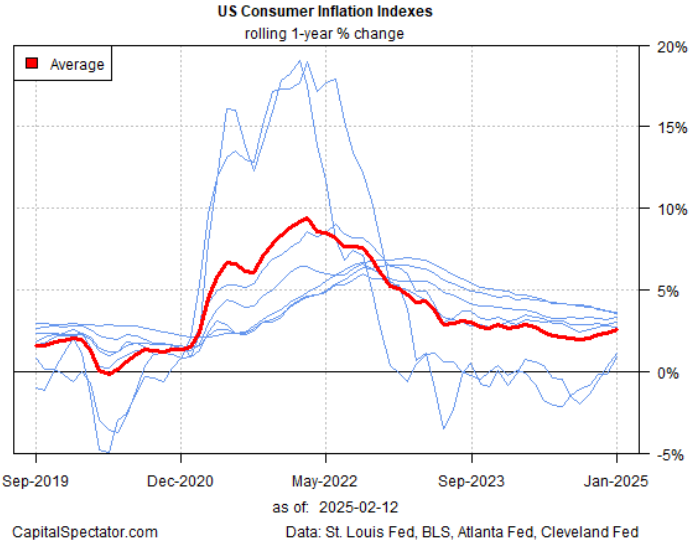
Consumer Price Indexes (CPI). Core CPI excludes food and energy, offering what tends to be a more reliable measure of the trend vs. headline CPI.

Headline/Core PCE Inflation Indexes: 1-Year Trend



Personal Consumption Expenditures (PCE) inflation measures. Core PCE excludes food and energy, offering what tends to be a more reliable measure of the trend vs. headline PCE. Core PCE is widely reported as the Federal Reserve's preferred measure of inflation.

Consumer Inflation Indexes: 1-Year Trend

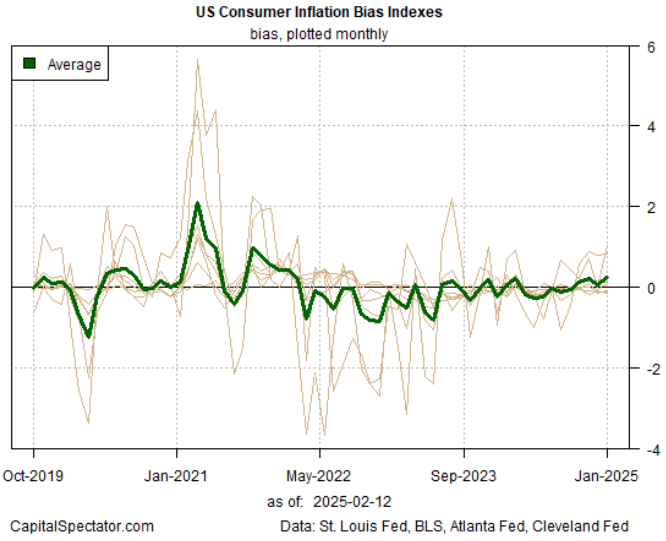


This chart offers a broad review of inflation indexes. The assumption is that including alternative measures of inflation provides a more robust estimate of the trend. In addition to the standard headline and core CPI estimates of inflation, the chart at left includes:

- *Sticky price core CPI*
- *Sticky price core CPI ex-shelter*
- *Median CPI*
- *Flexible CPI*
- *Flexible core CPI*

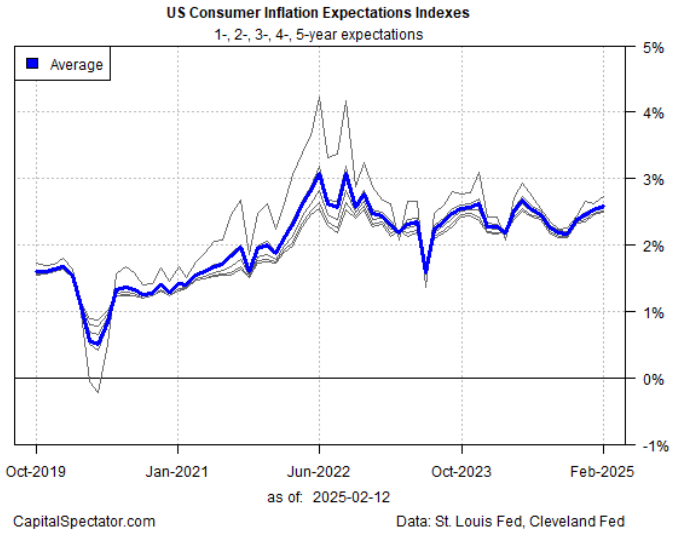
For details on the alternative CPI numbers, see: fred.stlouisfed.org and related links to the regional Fed banks that maintain the data.

Consumer Inflation Bias Indexes



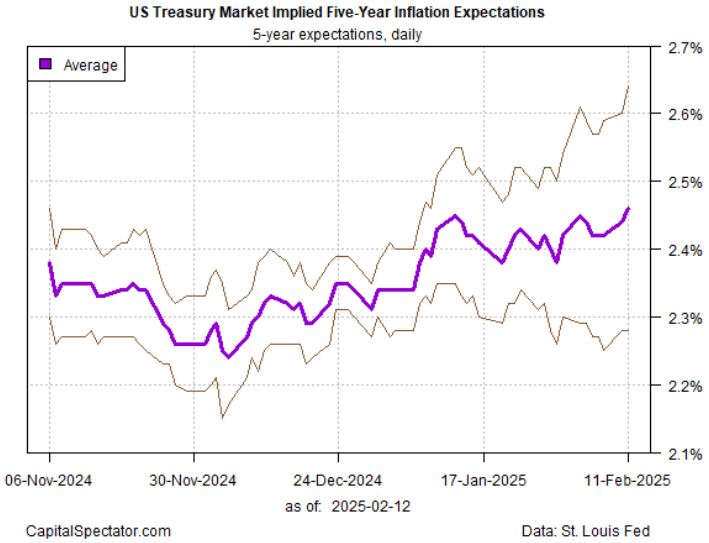
The bias indexes are calculated by comparing the month-to-month change in the rolling 1-year changes for the indexes listed directly above.

Consumer Inflation Expectations Indexes



Model estimates of inflation expectations for various time horizons, based on analytics from the Cleveland Fed. See www.clevelandfed.org for details.

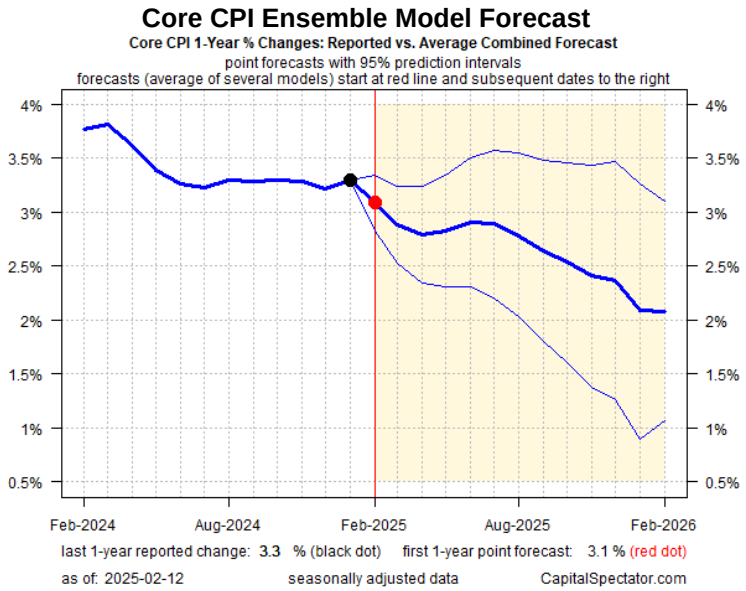
Treasury Market 5-Year Inflation Forecasts



Five-year inflation expectations based on two models. The first is 5-Year/5-Year Forward Inflation Expectation Rate. For details, see:
fred.stlouisfed.org/series/T5YIFR

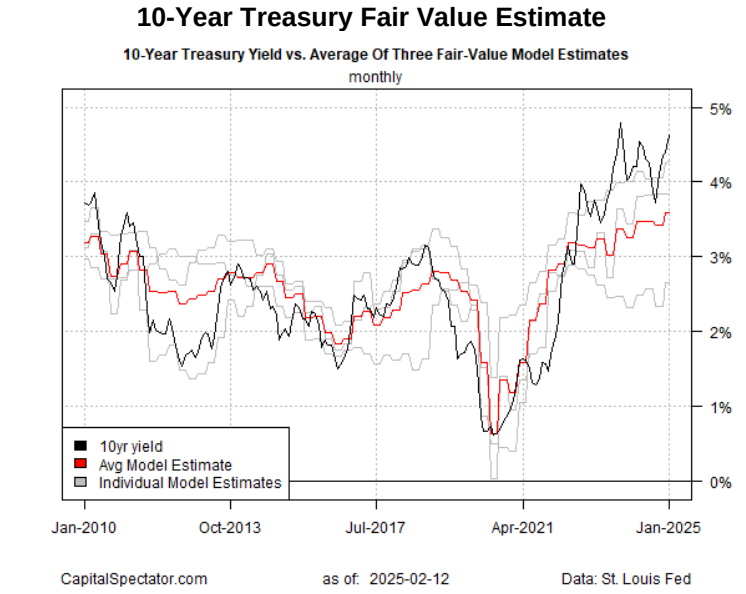
The second model is based on the implied market forecast using the yield spread on the 5-year nominal Treasury less its inflation-indexed counterpart.

The chart at left also shows the average of these two models.



The Ensemble model forecast of core CPI is based on analytics developed by CapitalSpectator.com. For details, see:

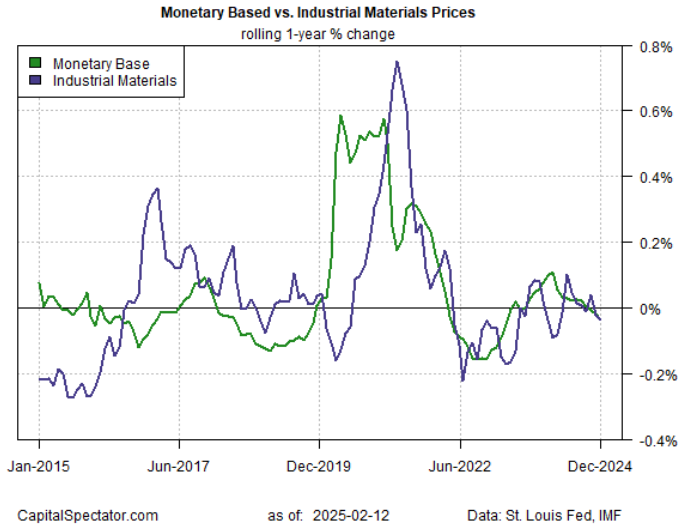
www.capitalspectator.com/combination-forecasts



The "fair-value" of the 10-year Treasury yield is based on three models. The average estimate offers a baseline for guesstimating the level of the 10-year yield according to a variety of economic and markets indicators. For details, see:

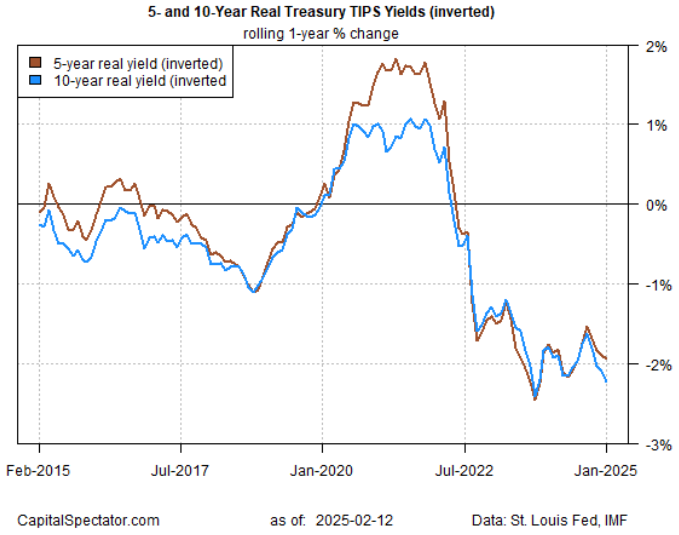
www.capitalspectator.com/10-year-treasury-yield-fair-value-estimate

Monetary Base vs. Industrial Materials Prices



The US base money supply and prices of industrial materials are useful indicators for estimating the trend bias for inflation. The main takeaway: stronger (weaker) trends imply stronger (weaker) inflation.

5- and 10-Year Real Treasury TIPS Yields (Inverted)



The rolling 1-year change (inverted) for 5- and 10-year real Treasury yields (via TIPS securities) offers a useful benchmark for estimating the near-term outlook for the inflation trend. The main takeaway: higher real yields (shown by falling trends in the chart at left) imply lower inflation, and vice versa.

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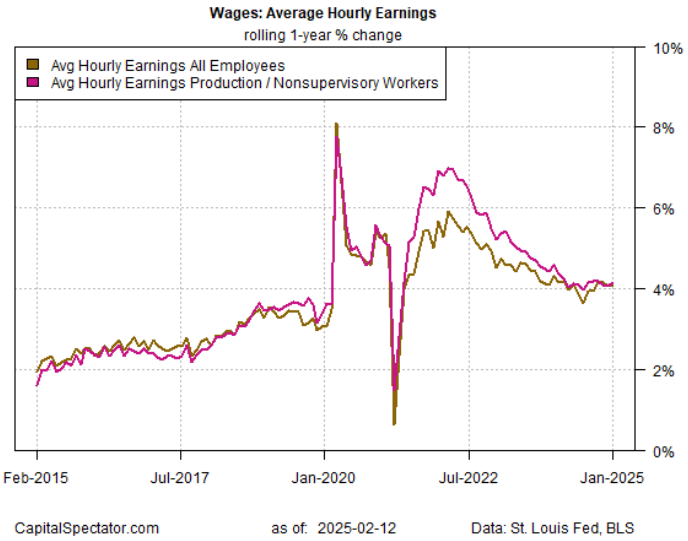
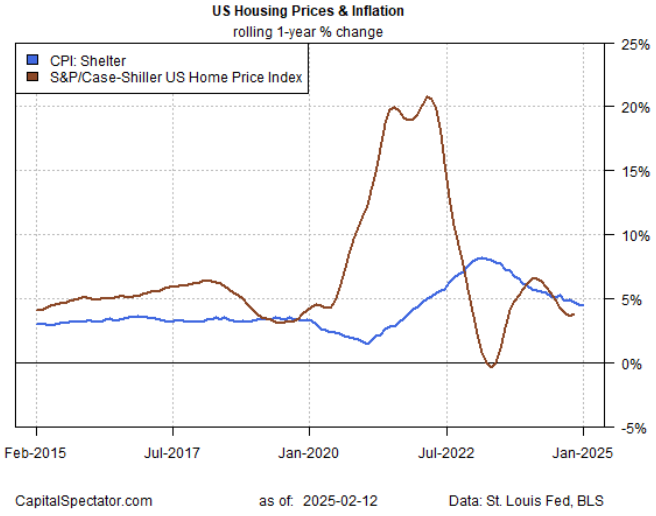
US Wages



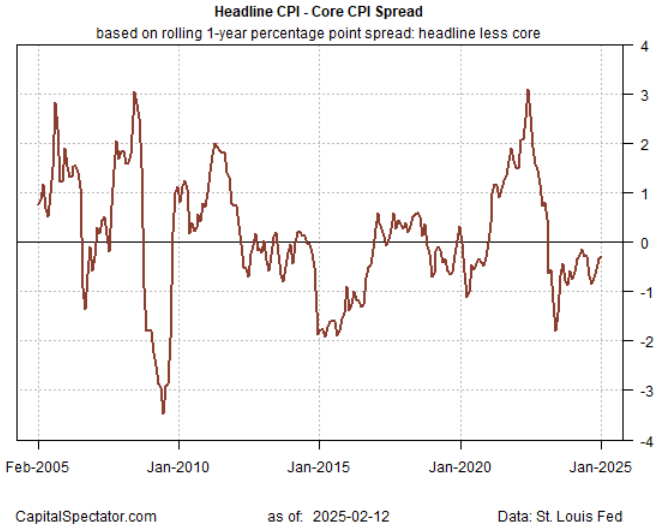
These indexes track the one-year change in average hourly earnings for two components of the labor market: Production and Nonsupervisory Employees, Total Private and the broader all-employees category

US Housing Inflation vs. Home Prices



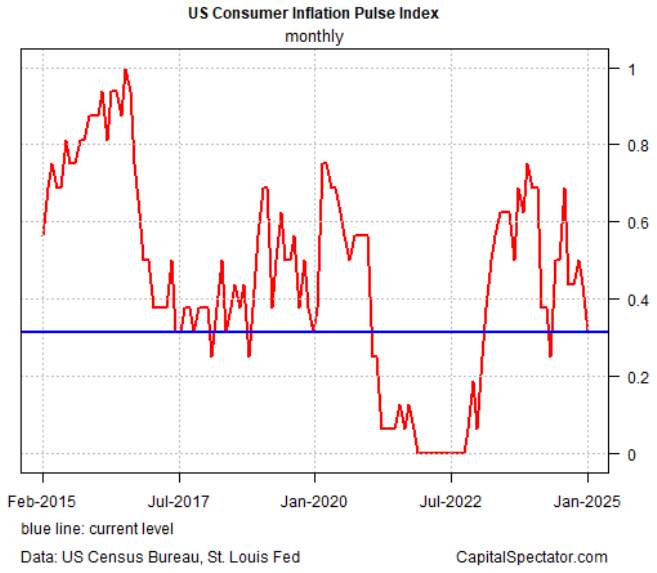
CPI Shelter tracks "the largest regular expense for most households," the Labor Dept. advises. There are two main components to CPI Shelter: owners' equivalent rent of residences and rent of primary residence. The S&P/Case-Shiller U.S. National Home Price Index captures the trend in US residential real estate prices.

Headline CPI – Core CPI Spread



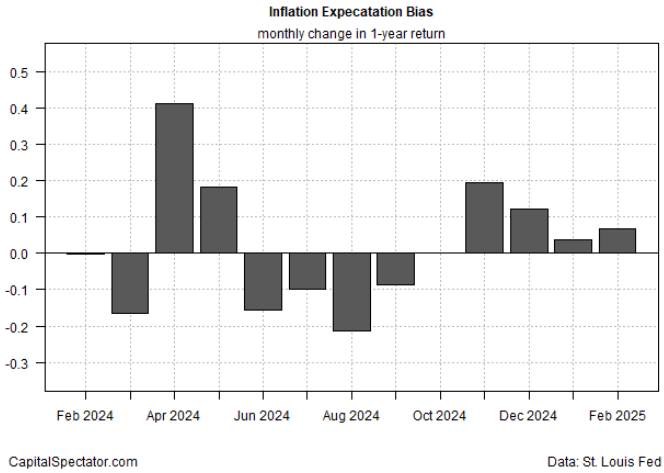
The Headline CPI – Core CPI spread is calculated based on the rolling 1-year % change for each index and taking the difference (headline less core). This spread tracks the bias in terms of whether the inflation trend is rising/falling. The assumption, which is supported by history to a degree, is that when headline CPI is above (below) core CPI, the inflation trend is rising (falling). Values below 0 indicate a disinflation bias vs. values above 0 indicate a reflationary/inflationary bias.

Consumer Inflation Pulse Index



The Inflation Pulse Index aggregates the 12-month percentage changes for all of the 32 components of the Consumer Price Index and scores each benchmark. The master score – Inflation Pulse Index – reflects the overall inflation bias. Readings range from 0 (a strong disinflation/deflation bias) to 1.0 (a strong inflation bias).

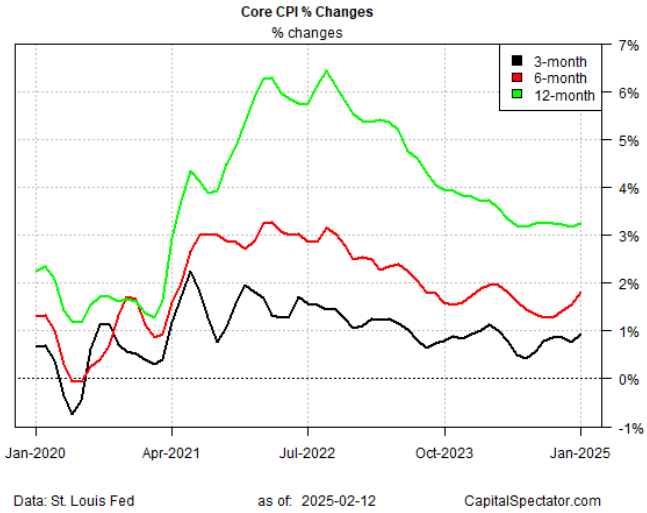
Inflation Expectations Bias Index



The Inflation Expectation Bias chart presents the average monthly change of the one-year differences for 1-, 2- and 3-year-ahead inflation expectations, based on models developed by the Cleveland Fed: https://www.clevelandfed.org/

The goal is to provide a relatively robust summary of how the inflation-expectations bias is changing from month to month. Positive (negative) readings reflect an increase (decrease) for inflation expectations.

Core CPI Changes



The 3-, 6- and 12-month % changes for the core rate of the Consumer Price Index (CPI) provide a profile of how the inflation-trend bias is evolving on three trailing windows. Monitoring this trio offers a fuller profile of the directional bias of pricing pressure compared to monitoring any one trailing period.