Economic Update

February 14, 2023

U.S. inflation pressures eased less than expected in January

- Headline CPI and "core" ex-food and energy lower at 6.4% and 5.6%, firmer than expected
- Breadth of CPI growth still narrowing: higher prices are impacting less goods and services in the U.S.
- Slower domestic spending drawing the Fed closer to the end of hiking cycle – we expect one last 25 bp increase in the Fed Funds target in March

RBC Inflation Watch: a tracker of key indicators on price trends in the US.

Read Report

January's inflation report came a bit firmer than expected with headline CPI growth dialing lower to 6.4% year-over-year from 6.5% in December. Food inflation slowed to a still-elevated 10.1% in January while energy CPI picked up to 8.7% as gasoline prices rose. Excluding those components, "core" inflation also ticked slightly lower, to 5.6% year-over-year or 0.4% month-over-month from December on a seasonally adjusted basis. Growth in rent costs again accounted for most of that monthly increase. CPI for car insurance and apparel also posted larger monthly increases in January, offsetting weakness among new and used cars, air fares and medical care services inflation. Moving forward, growth in food and energy prices will very likely continue to moderate, following lower global commodity prices – agriculture and energy indices have both been trending towards pre-pandemic levels. On balance, the breadth of inflation pressure in the U.S has still been improving. That means less goods and services consumed by U.S. households – we counted 50% of the CPI basket (ex-shelter) were impacted by abnormally high (+5% annualized) inflation over the past 3 months, down from 80% in early 2022.

Claire Fan | Economist, RBC Economics | Royal Bank of Canada | T. (416) 974-3639s
For more economic research, visit our website at *https://thoughtleadership.rbc.com/economics/*

One firmer CPI print should not alter the fact that inflation pressures in the U.S. overall have been improving. The Fed's more recently preferred measure for CPI that strips out food, energy and rent inflation ("core" services CPI ex-rent), has remained roughly unchanged at an annualized 4.1% over the last three months to January. That's still high but has come a long way from over 9% in summer 2022. Consumer spending meantime has continued to soften. Goods purchases had been outright declining by the end of 2022, and growth in spending on services also ground to a halt. The key risk to that outlook remains an overheating labour market, which seems at odds with every other indicator, including factory shipments and survey data suggesting domestic activity losing steam. Job growth in the U.S. has time and again surprised to the upside. But openings outside of the extremely short-staffed leisure and hospitality industry have been trending lower on balance, and so did wage growth. Stronger labour markets and firmer inflation could push the Fed to hike interest rates more than previously expected. But for now we maintain our view for the Federal Reserve to raise the target range by another 25 bp in March, and for that to be their last move this cycle. That will bring the terminal rate up to 5% after a total of 475 bp worth of rate hike, which are expected to further slow spending and inflation later this year.

Fed's preferred inflation measure edging lower

Source: Bureau of Labor Statistics, RBC Economics Research

U.S. CPI Growth

	Oct-22	Nov-22	Dec-22	Dec-22
	MoM % change (SA)			*YoY % change*
Headline	0.2	0.1	0.5	6.4
Food	0.6	0.4	0.5	10.1
Energy	-1.4	-3.1	2.0	8.7
Core	0.3	0.4	0.4	5.6
Goods ex food and energy	-0.2	-0.1	0.1	1.4
Services ex energy	0.5	0.6	0.5	7.2