December CPI

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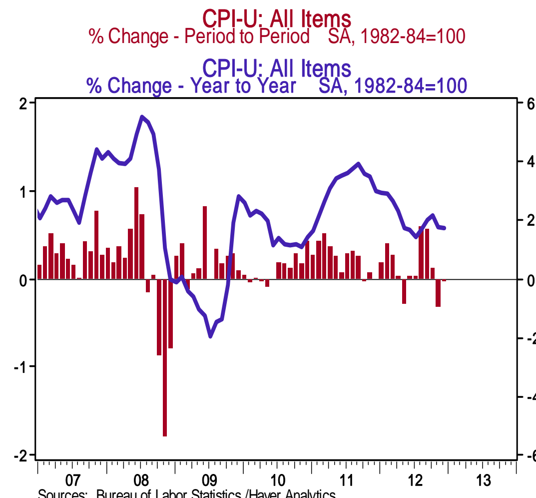
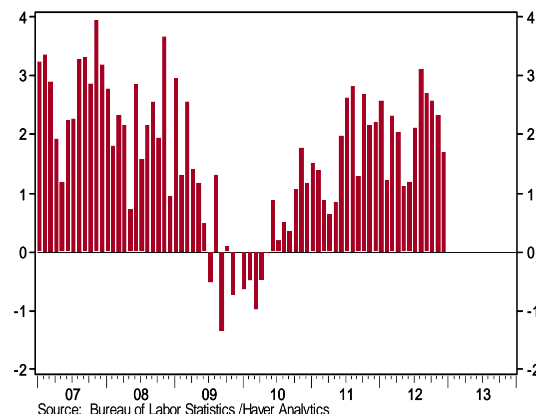
- The Consumer Price Index (CPI) was unchanged in December, exactly as the consensus expected. The CPI is up 1.7% versus a year ago.
- "Cash" inflation (which excludes the government's estimate of what homeowners would charge themselves for rent) fell 0.1% in December but is up 1.6% in the past year.
- The CPI was unchanged in December, with a 1.2% decline energy prices offsetting increases in most other major categories. Food prices rose 0.2%. The "core" CPI, which excludes food and energy, was up 0.1% in December and is up 1.9% versus a year ago. The consensus expected gain of 0.2% in December.
- Real average hourly earnings – the cash earnings of all employees, adjusted for inflation – were up 0.3% in December and are up the same amount in the past year. Real *weekly* earnings are up 0.6% in the past year.





Implications: All continues to be quiet on the inflation front. Consumer prices were unchanged in December, with falling energy prices offsetting gains in food, housing, hospital services, airfare and tuition. That's been the recent theme, with the overall CPI down at a 0.7% annual rate in the past three months, all due to energy. Still, in the past year energy prices are up 0.5% and the overall CPI is up 1.7%. "Core" prices, which exclude food and energy, were up only 0.1% in December, coming in slightly lower than consensus expectations, and are up 1.9% from a year ago. Neither figure sets off alarm bells. Instead, they suggest the Federal Reserve's preferred measure of inflation, the PCE deflator (which usually runs a ¼ point below the CPI) remains below the Fed's target of 2%. We don't expect this to last. With nominal GDP growth – real GDP growth plus inflation – running at 4%+, a federal funds rate at essentially zero will generate higher rates of inflation in the year ahead. Look for housing, which makes up about 30% of the CPI, to be a large contributor to higher inflation in the next few years. It's important to recognize that the Fed will not start raising rates just because inflation gets above its target of 2%. For the Fed, the key measure of inflation is its *own forecast of future inflation*. So even if inflation goes to roughly 3% this year, as long as the Fed projects the rise to be temporary it will not react by raising short-term interest rates. The Fed is more focused on the labor market and, we believe, is willing to let inflation exceed its long-term target of 2% for a prolonged period of time in order to get unemployment down to its target of 6.5%. The best news in today's report was that "real" (inflation-adjusted) average hourly earnings rose 0.3% in December. In the past three months they are up at a 2.8% annual rate.

CPI - U *All Data Seasonally Adjusted*	Dec-12	Nov-12	Oct-12	3-mo % Ch. annualized	6-mo % Ch. annualized	Yr to Yr % Change
Consumer Price Index	**0.0%**	-0.3%	0.1%	-0.7%	2.1%	1.7%
Ex Food & Energy	**0.1%**	0.1%	0.2%	1.6%	1.4%	1.9%
Ex Energy	**0.1%**	0.1%	0.2%	1.7%	1.5%	1.9%
Energy	**-1.2%**	-4.1%	-0.2%	-20.1%	8.0%	0.5%
Food and Beverages	**0.2%**	0.2%	0.2%	2.6%	1.9%	1.8%
Housing	**0.1%**	0.3%	0.2%	2.6%	2.4%	1.7%
Owners Equivalent Rent	**0.1%**	0.2%	0.2%	2.2%	2.4%	2.1%
New Vehicles	**0.0%**	0.2%	-0.1%	0.1%	-0.1%	1.6%
Medical Care	**0.1%**	0.1%	0.0%	1.0%	2.2%	3.2%
Services (Excluding Energy Services)	**0.2%**	0.2%	0.3%	2.7%	2.4%	2.5%
Real Average Hourly Earnings	**0.3%**	0.6%	-0.2%	2.8%	-0.2%	0.3%

Source: U.S. Department of Labor

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