

Economic Analysis

# Headline CPI Down for Third Consecutive Month

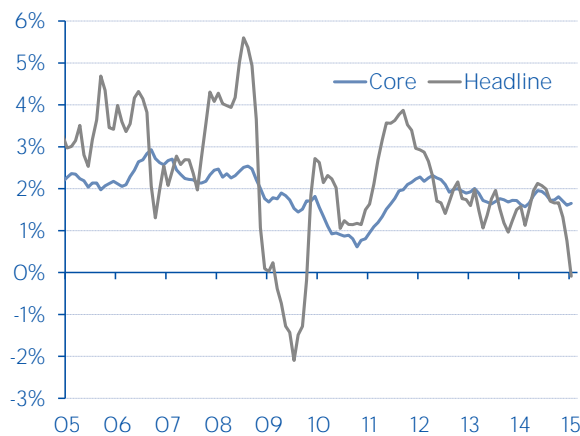
Kim Fraser Chase

- **CPI declined a massive 0.7% in January and dropped 0.2% on a YoY basis**
- **Core inflation increased at a healthy 0.2% as the services components continue to gain**
- **We expect to see positive inflation in February but our annual forecast remains low**

Downward pressures on inflation intensified in January, with both food and energy prices weighing on headline CPI. As expected, energy prices declined for the seventh consecutive month, reflecting a significant 18.7% drop in the gasoline index. In an unusual twist for the CPI report, prices for food at home fell 0.2% for the first time since May 2013, mostly stemming from dairy and related products as well as fruits and vegetables. This was mostly offset by a modest increase in the prices of food away from home. Overall, headline CPI declined 0.7%, marking the largest monthly drop since December 2008. Excluding food and energy, prices increased 0.2% following a 0.1% increase in December. This confirms our view on the limited pass-through to core inflation.

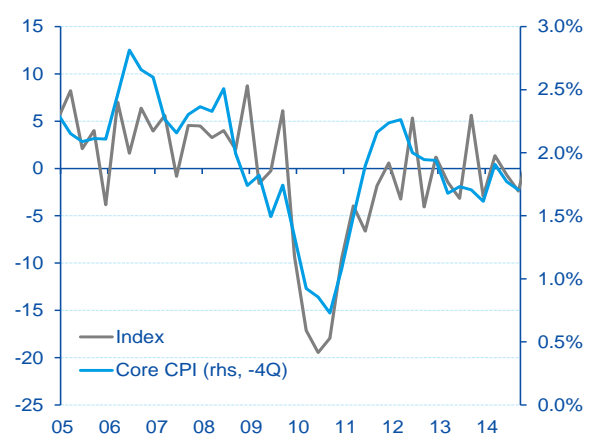
January's significant drop in headline inflation is likely to be the last for a while. We have already seen a measurable increase in energy prices throughout February thus far, with Brent crude oil prices up nearly 25% since January 30<sup>th</sup>. WTI prices have increased a more modest 6% since the end of last month. Natural gas prices have also ticked up more than 11% throughout the past few weeks. All of this suggests a positive adjustment for headline CPI in February, with core inflation expected to remain slow but steady. Despite our expectations for stronger upward pressures in the coming months, our forecast for average inflation in 2015 remains low. January's YoY inflation rate was much lower than expected, at -0.2% compared to 12 months ago, so we would need to see a significant pickup in 2H15 in order to achieve an annual average near 1.5%. Core inflation is falling right in line with our expectations at 1.6% YoY in January, setting up nicely for an annual average near 1.9% for 2015.

Chart 1  
**Headline and Core Inflation (YoY % Change)**



Source: Bureau of Labor Statistics & BBVA Research

Chart 2  
**BBVA Research U.S. Inflation Risk Index (Higher risk<0; Lower risk>0)**



Source: Bureau of Labor Statistics & BBVA Research

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