Economic Analysis

Core CPI Continues Upward Trend in February

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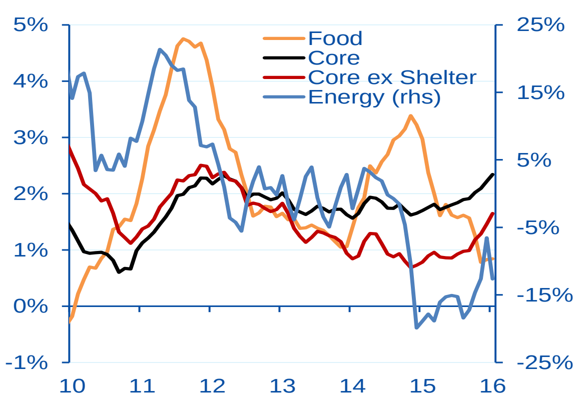
- **Core CPI rose to 2.3% YoY, supporting another rate increase in the coming months**
- **A third consecutive monthly decline in energy prices dragged down headline CPI**
- **Transitory pressures lasting longer than expected but the pass through to core is limited**

February's CPI report hints that the doves at the Fed are going into the second day of the FOMC meeting with a little pep in their step. Despite an energy-driven decline in the headline figure, core inflation continued its upward trend, rising 0.3% for the second consecutive month. This brings the YoY figure to 2.3%, the highest since April 2012 and a big step toward the Fed's inflation target. It is important to remember that the Fed's target of 2.0% refers to core PCE inflation, which tends to run roughly 0.5 percentage points lower than core CPI. Therefore, we have to keep in mind that the implied core CPI target is closer to 2.5%. While we don't expect that this report will force a rate hike announcement at today's FOMC meeting, it will certainly keep the Fed motivated to increase rates again later this year. June remains a strong possibility for another 25 basis point increase.

When it comes to headline inflation, transitory downward pressures are still at play, dragging on a bit longer than the Fed had originally predicted. Despite an increase in Brent crude oil prices in February, the energy price index dropped nearly 6.0% MoM to mark the third consecutive monthly decline. This was likely driven by a 14.0% drop in natural gas prices, as well as a 3.4% decline in WTI prices. Energy commodities dropped 12.5%, driven mostly by motor fuel, whereas energy services increased for the first time in six months due to a boost from utility gas service.

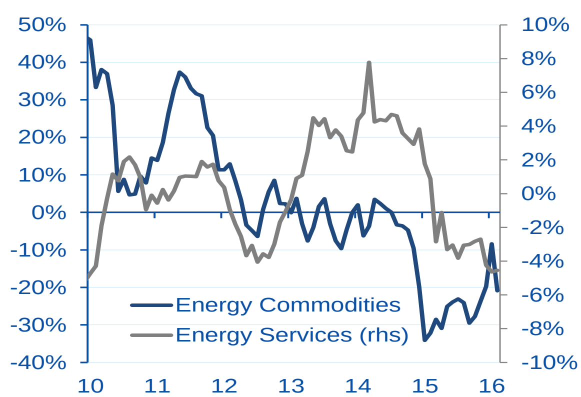
With oil prices still on a shaky path, headline inflation will remain weak. Although we saw Brent and WTI jump near $40/barrel in early March, both have already started to retreat, likely putting additional downward pressure on headline inflation for the month. However, the good news is that the potential for any pass-through to core inflation is limited given the rising strength of the domestic economy as we move into 2Q16.

Chart 1
Headline & Core CPI (YoY % Change)



Source: BLS & BBVA Research

Chart 2
Energy Services & Commodities (YoY % Change)



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