

Economic Analysis

Healthy Gains in Inflation Bode Well for Fed Action

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- **Headline CPI increased 0.4% MoM, the most since February 2013**
- **Core inflation rose a solid 0.2% MoM despite continued declines in core commodities**
- **The 2.15% YoY pace for core CPI adds to the list of reasons in favor of a June rate increase**

Inflation continues to move in line with Fed expectations as temporary downward pressures dissipate. Oil prices have been on the rise since February, crossing over the \$40/bbl threshold in mid-April. This made for a 3.45% monthly gain in the energy price index in April, with headline CPI inflation up 0.4% -- the most since February 2013. On a YoY basis, headline inflation rose to 1.1%.

Core consumer prices also posted healthy gains in April, up 0.2% for the month and up 2.15% on a YoY basis. This actually marks a slight deceleration in the YoY pace throughout the past few months (from 2.3% in February). There has been talk of seasonal volatility in inflation data and therefore the most dovish FOMC members have felt it is important to remain cautious and not get too excited about core inflation gains thus far, most of which continue to be driven by shelter and medical care. Still, it is hard to ignore the fact that core inflation has gradually approached the Fed's target—reaching the highest point in nearly three years—and inflation expectations are climbing back from hitting seven-year lows in February. Although inflation will continue to run below target for the foreseeable future, downward pressures are fading. This should provide some comfort to the most dovish FOMC members in moving forward with at least one additional 25 basis point rate increase in 2016.

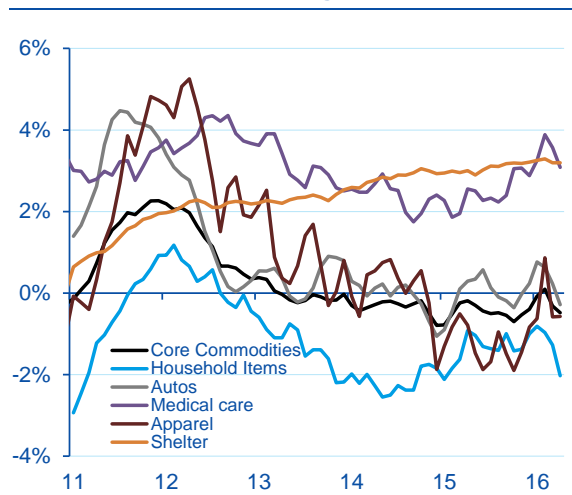
Still, slow but steady inflation adds to the growing list of reasons for why the Fed should announce another rate increase in June, continuing its gradual normalization process initiated back in December. It is important to remember that this is just the second of many future rate hikes to come, so the Fed does not need inflation to already be at their target. In general, they just need the data to be convincing enough that eventually conditions will meet their objectives. April's CPI data are certainly encouraging in that direction.

Chart 1
CPI Components, April 2016

CPI	MoM	YoY
Total	0.41%	1.14%
Food	0.18%	0.93%
Energy	3.45%	-8.71%
Core	0.19%	2.15%
Core Commodities	-0.10%	-0.48%
Apparel	-0.25%	-0.57%
Medical Care Commodities	0.46%	2.68%
Core Services	0.29%	3.02%
Shelter	0.28%	3.20%
Medical Care Services	0.28%	3.08%
Core Ex Shelter	0.13%	1.38%

Source: BLS & BBVA Research

Chart 2
Core Inflation (YoY % Change)



Source: BLS & BBVA Research

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