SUMMARY

- The consumer price index fell 0.7 percent in January, but core prices were up 0.2 percent. Total prices were down by 0.2 percent from one year earlier, but core inflation held steady at 1.6 percent.

- Durable goods orders rose 2.8 percent in January, making up most of their December decline.

- New home sales fell very slightly in January, while house price growth continued at a moderate pace in December.

- Initial unemployment insurance claims rose in the President’s Day holiday week ending February 21, but the four-week moving average remained below 300,000.

- In Congressional testimony Fed Chair Yellen indicated that the first increase in the Federal funds rate will not come in the next couple of meetings, but that conditions do point to a near-term rate increase.

- The first FOMC rate hike is likely to come in the third quarter of 2015, but the timing will depend on the FOMC’s confidence in their inflation outlook.

- The economy continues to expand at a solid pace in early 2015, dinged temporarily by severe winter weather.

The consumer price index fell 0.7 percent in January, the third straight monthly decline in the topline CPI. There was a 9.7 percent drop in energy prices, including an 18.7 percent plunge in gasoline prices, the seventh straight monthly decline. Core prices, excluding food and energy, were up 0.2 percent in January.

The huge drop in gasoline prices is a big positive for consumers. With the decline in the CPI inflation-adjusted average hourly earnings rose a whopping 1.2 percent in January. The big decline in gasoline prices in recent months will allow consumers to boost their spending on other items in 2015, supporting overall economic growth.

On a year-over-year basis the CPI was down 0.2 percent, compared to a 0.7 percent increase in December. This is the first negative reading on year-ago inflation since 2009, during the Great Recession. Inflation has temporarily moved further away from the Federal Open Market Committee’s 2 percent target (using a different inflation measure, the personal consumption expenditures price index). However, the core CPI was up 1.6 percent in January from one year earlier, the same pace of inflation as in December (see Chart 1). So far, outside of energy, inflation has not slowed.

Durable goods orders rose 2.8 percent in January, offsetting much of December’s 3.7 percent decline. This was the first increase in durable goods orders since a small gain in October. There was a big jump in orders for Boeing; orders excluding transportation goods rose 0.3 percent in January. Core capital goods orders—nondefense capital goods, excluding aircraft—rose 0.6 percent in January, the first gain since August. Durable goods shipments fell 1.1 percent over the month, with a 0.3 percent decline for core capital goods shipments. In a positive for fourth quarter growth, the initially reported small decline in core capital goods shipments in December was revised up to a small increase.

The durable goods report was modestly positive. In addition to the good headline number the details were solid. Business investment will contribute to growth in the near term with support from record profits, lower energy costs, increasing demand, and low borrowing costs. However, weak global demand and a strong dollar will weigh on durable goods exports, and reduced investment in energy will also be a headwind.
Sales of new homes fell very slightly in January, down 0.2 percent to 481,000 at a seasonally-adjusted annualized rate. Sales rose in the South and Midwest, but fell in the West and Northeast. The inventory of new homes for sale held steady at 5.4 months at the current sales pace. The median sale price fell slightly over the month to $299,100, but was up 9.1 percent from one year earlier.

The Case-Shiller national home price index rose 0.7 percent from November to December after seasonal adjustment. On a year-ago basis the Case-Shiller was up 4.6 percent in December, down slightly from 4.7 percent growth in November. Prices rose in all 20 of the metro areas covered in the December release, with the biggest gains in Denver, Detroit, San Francisco and Seattle. Prices were also up in all 20 metro areas from one year earlier, with the largest gains in San Francisco, Miami and Denver.

The housing market continues its modest improvement. Sales of new homes are moving higher, but remain far below their levels during the housing boom (see Chart 2).

Low mortgage rates, pent-up demand, solid job and income gains and increased access to mortgage credit will continue to drive sales higher throughout 2015. New, looser rules on mortgage lending will also support sales growth this year. Prices for existing homes are rising at a mid-single digit pace, consistent with income growth and thus sustainable over the longer run.

Initial claims for unemployment insurance jumped to 313,000 in the Presidents’ Day week ending February 21, up from 282,000 in the prior week (revised down from 283,000). This was the first time claims were above 300,000, and the highest level of claims, since the first half of January. The four-week moving average of claims rose from 283,000 to 294,500.

Claims are often volatile at this time of year because of the weather and holidays. Claims are running at a pace of around 300,000 per week, consistent with monthly job growth of better than 200,000. PNC is forecasting payroll job growth of 235,000 and a decline in the unemployment rate.

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**Chart 1: Core Inflation Holding Steady Despite Plunge in Energy Prices**

Consumer price index, % change year ago

Excluding food and energy

All items

Chart source: Bureau of Labor Statistics
rate to 5.6 percent when the BLS releases the February employment report on March 6. Job growth in the U.S. continues to run at a pace well above trend, allowing for the reabsorption of workers still unemployed and "underemployed" in the aftermath of the Great Recession.

Federal Reserve chair Janet Yellen gave her semiannual monetary policy before Congress this week. In its recent statements the Federal Open Market Committee has said the central bank can be "patient" in raising its key policy rate, the Federal funds rate; in her testimony Yellen said that this means a couple of meetings, implying that the first rate hike would come no sooner than June. Yellen also signaled that the "patient" language could soon be dropped. Yellen also said that the FOMC would like to see stronger inflation and faster wage growth. It would be difficult to raise rates with the CPI down year-over-year, although headline inflation should soon pick up as energy prices have stabilized and started to move higher; gasoline prices are up 30 cents per gallon in the past month. Gas prices will move higher as is typical during the spring months but still be close to $1.00 a gallon lower than in spring 2014. The FOMC will be looking for signs of an acceleration in inflation before raising rates, and the first rate hike is likely to come in the third quarter of 2015.

The U.S. economy continues to expand at a solid pace in early 2015, despite a temporary drag from severe weather. Consumers are spending more thanks to solid job growth and moderate income growth, and lower energy prices are freeing up cash to spend on other goods and services. Business investment will increase thanks to rising profitability and low borrowing costs. The drag from government has faded with less emphasis on deficit reduction. The major headwind will be trade, with weak overseas growth and the strong U.S. dollar a drag on exports. PNC is forecasting real GDP growth of 3.2 percent from the fourth quarter of 2014 to the fourth quarter of 2015, compared to 2.4 percent over the same period of 2014.

Chart 2: Home Sales Moving Higher, But Still Lots of Room for Growth

Single-family home sales, 3-month moving average, seasonally adjusted annualized rate, ths

Existing (R)

New (L)

Chart sources: Census Bureau, National Association of Realtors

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