Economic Update

February 13, 2024

Inflation Picked Back Up Again in January, Another Reason for Fed Not to Cut Rates in March; PNC Changes Baseline Forecast for February to Slower Growth, But No Recession

- **Both overall and core CPI inflation picked up in January, with the biggest increases in months.**
- **CPI inflation on a year-over-year basis has been slowing.**
- **Core services, including housing, has been the primary driver of high inflation in late 2023 and early 2024.**
- **Inflation will further slow over the course of 2024.**
- **Stronger inflation is the primary reason why the FOMC won't cut the fed funds rate at its next meeting, in early March. PNC does expect fed funds rate cuts later this year.**
- **PNC is moving to slower economic growth in 2024 in its baseline forecast, a change from its previous recession forecast.**

The consumer price index for all items rose 0.3% in January from December after seasonal adjustment, the fastest month-to-month inflation since September. The core CPI, excluding volatile food and energy prices, rose 0.4% in January, the biggest increase since April. This included a 0.3% decline in core goods prices, and a 0.7% increase in core services prices. Food prices rose 0.4% in January, with energy prices down 0.9%.

Shelter inflation was 0.6% in January, the fastest pace since September. Shelter has been a big contributor to elevated core services inflation over the past couple of years. The price of owner-occupied housing (owners' equivalent rent) was up 0.6% in January, with rents up 0.4%.

On a year-ago basis overall inflation was 3.1% in January, down from 3.4% in December, but matching the November pace. Core CPI inflation was 3.9% year-over-year in January, the same pace as in December. This is the lowest year-ago core inflation since mid-2021. Year-ago overall CPI inflation peaked at 9% in mid-2022, while core inflation peaked at 6.6% in September 2022. This was the highest inflation since the early 1980s.

Inflation picked back up in January after slowing at the end of last year, with both overall and core inflation reaccelerating on a monthly basis in January. Year-over-year inflation, both overall and core, has stabilized over the past few months after falling in late 2022 and through most of 2023. Although inflation is now much lower than it was in 2022, it is still well above its pre-pandemic pace.

The Federal Reserve focuses on another inflation measure, the personal consumption expenditures price index, which tends to run a bit more slowly than CPI inflation. The PCE inflation numbers for January will be released on February 29. But the reacceleration in inflation in January is likely to show up in the PCE numbers as well. Core PCE inflation remains well above the Federal Open Market Committee's 2% objective on a year-ago basis (2.9% in December), although it has been at just around 2% annualized over the past six months.

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The biggest concern with inflation in early 2024 is core services prices. Some of this is coming from strong shelter inflation, but that should fade this year as rent growth slows. Measured rent growth is slowing significantly with some rent measures falling, but these numbers work their way into the rental CPI with a lag. But the tight labor market and strong wage growth is pushing up other services prices.

Higher January CPI inflation is another reason why the FOMC will not cut the fed funds rate at its next meeting, on March 20. The committee wants to see more progress on inflation before it feels comfortable cutting its policy rate. The January reacceleration is likely an aberration; inflationary pressures in the US economy are gradually easing. In particular, more slack in the labor market and slower rent growth will contribute to a slowing in services inflation this year.

PNC expects the FOMC to cut the fed funds rate on May 1, by 25 basis points, as inflation slows. PNC then expects three additional 25 basis point rate cuts later this year, which would take the fed funds rate to a range of 4.25% to 4.50% by the end of 2024.

These expected rate cuts will support economic growth in 2024 and 2025. With inflation slowing and the labor market strong in early 2024, PNC is moving to a forecast for slower economic growth this year, a change from its previous baseline forecast for a near-term mild recession.

Inflation risks are to the upside. Conflict in the Middle East could increase energy prices and shipping costs. Additionally, the still-tight labor market could keep wage pressures elevated and contribute to continued inflation above the Fed's 2% objective.

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