Economic Update

March 13, 2025

PPI Inflation Backs Down from January's Jump at -0.01% for February 2025

- **Final Demand PPI declined by 0.01% on a seasonally adjusted basis in February 2025**
- **Producers' Energy prices fell by 1.2% for the month in February 2025, giving back some of the December & January spike upward**
- **Goods PPI halved its pace of gain in February 2025 versus the month prior, rising by 0.3%**
- **Services PPI fell by 0.2% for the month, breaking back below the 4.0% year-over-year threshold**

The Producer Price Index (PPI) was virtually flat in February 2025 versus January, falling by 0.01% for the month on a seasonally adjusted basis. This result translates to a 3.2% year-over-year gain and the first slowdown in that measure after topline PPI growth had accelerated for five months straight through the open of the new year. Goods PPI growth decelerated significantly in February 2025 to +0.3%, while the prices facing services-oriented businesses fell outright for the month at -0.2%. The February results were below PNC's expectations for PPI inflation and present a bit of a pressure release mechanism with inflation pressures having regained upward momentum in recent months and uncertainty regarding the potential impact of tariffs continues to swirl.

February 2025's Goods PPI result breaks what had begun to look like a new fever pitch for manufacturers' cost trends. Goods PPI grew by 0.3% for the month, down from 0.5% and 0.6% results in each of the previous three monthly reports. Versus one year ago, Goods PPI is up by 1.7% after briefly breaking above the 2.0% benchmark in January (+2.3%). The less organic supply & demand pressure there is on producers' costs under current conditions, the better, considering that any sustained application of tariffs will raise prices on the raw materials currently sourced by U.S. producers, which ultimately will be passed on to consumers and further delay the Federal Reserve in achieving its 2.0% overall consumer price inflation target. While the argument has been made by the Trump administration that consumers can avoid paying tariff-impacted prices by simply buying U.S.-made goods, the holes in that argument are many, beginning with the fact that U.S.-made goods likely already come at a higher cost – which may well be why the same consumers weren't purchasing that option in the first place. But reorganizing raw materials supply sourcing and ramping up U.S. production of raw materials to fill the gap left by higher-cost imports will take time and manufacturers are unlikely to *not* pass on any higher costs they face in the meantime, if that transition takes place at all.

A decline in Services PPI growth for February 2025 offers a less complicated positive outcome for supply-side inflation pressures. The -0.2% monthly growth result for Services PPI brings year-over-year growth for service businesses costs to +3.9%. While this is still a significantly stronger pace of growth than the near-2% year-over-year gains seen in late 2023, it is down from the peak of 4.4% growth reached to open this year. Services PPI includes retail sale of goods alongside the provision of actual services, both of which will serve as

Gus Faucher
Chief Economist

Jay Hawkins
Senior Economist

Stuart Hoffman
Senior Economic Advisor

Kurt Rankin
Senior Economist

Ershang Liang
Economist

the canary in the coalmine for any tariff-induced price pressure as they have the capacity to reflect price changes more quickly than the Goods PPI, which only makes its way to consumers after several layers of production, transportation, and wholesale-to-retail inventory management. The weaker February 2025 result on Services PPI suggests that businesses are not attempting to frontrun any expected tariff pricing impacts by raising prices ahead of any actual cost increases faced. The evolution of businesses cost pressures as reflected in Services PPI will be an action-packed storyline in the months to come.

Energy PPI broke a four-month streak of gains in February 2025, falling by 1.2% for the month. Volatility in businesses' Energy costs has been significant to start 2025, pushing the year-over-year pace of growth in the category into positive territory in January (+0.1%) before falling back into decline in February to the tune of -3.8%. Oil prices remain below $70 per barrel (West Texas Intermediate), relieving any potential for top-of-the-house oil prices to induce upward inflation pressure on businesses or consumers likely through the entire remainder of the first half of 2025.

The softening in business cost growth seen in the February 2025 PPI report supports PNC's expectation of two (2) interest rate cuts by the Federal Reserve through the remainder of 2025, which are expected to come from the Federal Open Market Committee's May and July meetings. Labor markets trends have weakened in recent months, though they have not fallen so far as to change the Fed's heading on monetary policy toward more panicked easing. However, hints of consumer uncertainty have emerged both in more nebulous economic indicators such as sentiment, and in hard numbers such as weaker retail sales in January 2025. Uncertainty regarding Federal government economic policy could merely have instilled temporary caution among U.S. consumers, but any measurable uptick in price growth – beginning with the costs faced by businesses and reflected in PPI growth – could quickly result in a sustained downward trend in spending habits given the hangover still lingering across U.S. households from the past three years' fight with inflation. The Fed will need to remain measured in its interest rate actions and its publicly provided guidance on the matter given the heightened risk that still surrounds inflation prospects.

PNC Economics
Kurt Rankin, Senior Economist
economics@pnc.com

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