Consumer Price Index

The Federal Reserve has been waiting for inflation to reach or exceed a magical 2.0% annual rate for a long time, since mid-2014. After a long wait, inflation reached 2.1% in December. The monthly increase reached 0.3% from November with most of the movement occurring in gasoline. This important resource increased 9.1% over the past 12 months. We knew this day would occur after watching a dramatic drop in gasoline prices much earlier as production far exceeded demand.

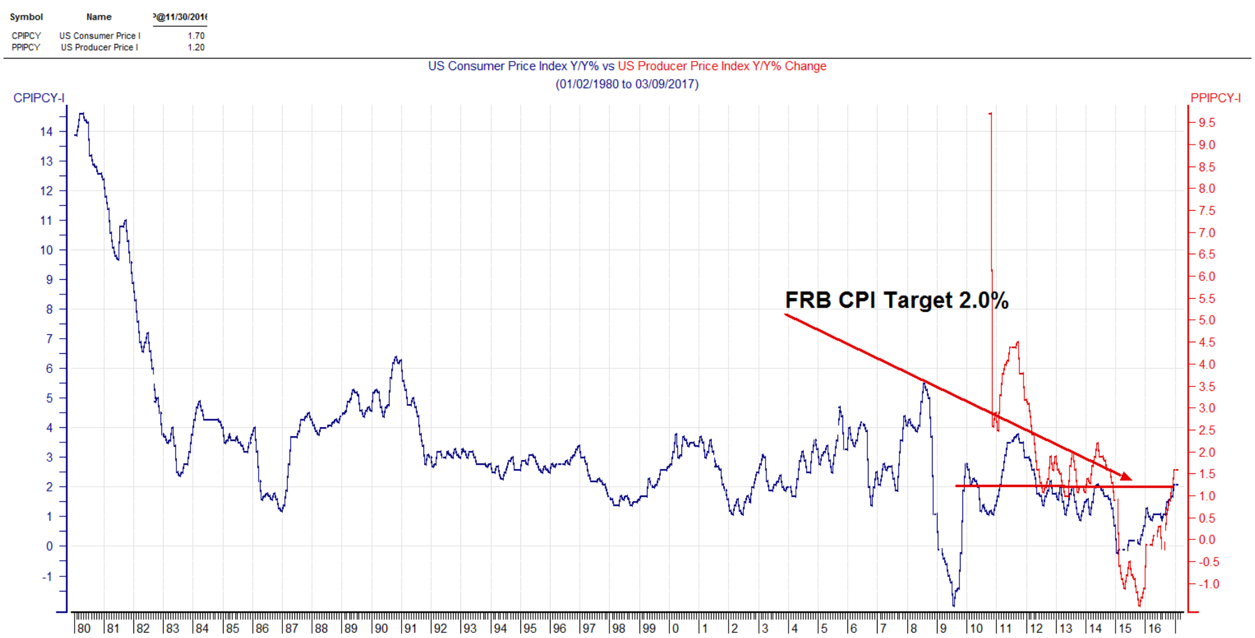

Figure 1: U.S. Consumer Price Index December 2017 & Producer Price Index

In our 2017 forecast we mentioned the probability that consumer inflation would begin to see an increase if producer inflation remained in the 1.0% to 2.0% increase. Figure 1 provides an excellent graphic of both producer inflation and consumer inflation increasing on an annualized basis.

A stronger U.S.$ also will exert higher increasing pressure on pricing. A stronger currency makes imported products less expensive on a relative basis and Americas love foreign products, at least today. In our recent, Trade Balance report we mentioned that imports are growing faster than exports thereby increasing our trade deficit. This action will also put upside pressure on prices.

Inflation at a 2.1% annualized level is not normally an important matter. But, in this case, the Fed has been waiting for a 2.0%+ level to increase interest rates. Is this enough? Most of the market expects three increases in 2017 reaching 0.75% by year-end. Given this recent increase in inflation, the probability of one increase of 0.25% is almost 100%. A second rate increase is near 75% and three increases is lower at 35%. Increases spaced over the year corresponding with continued consumer inflation above 2.0% would warrant the increases. Our forecast remains on-track with these recently reported numbers.

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