The Daily Dish

January Consumer Price Inflation

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Already too many words have been written about yesterday's Bureau of Labor Statistics (BLS) report on the January Consumer Price Index (CPI), but hey, it's an era of inflation so too much of everything is evidently in order. Here goes.

The top-line CPI rose at an annual rate of 7.5 percent and "core" (non-food, non-energy) inflation was up 6.0 percent; both were 0.5 percentage points faster than in the previous month. Eakinomics' favorite measure of the politically relevant inflation – food, energy, and shelter that comprise over 50 percent of the typical budget – rose even faster: up 8.1 percent from January 2021. The basic picture is that inflation is high and rising.

The most troubling number, however, was the 4.4 percent annual rate for shelter price inflation. This was a sharp jump of 0.3 percentage points from the December reading of 4.1 percent. Shelter is a big part of the CPI—one-third—and tends to rise and fall fairly smoothly. So unlike, say, food or energy, one does not expect shelter inflation to explode north or suddenly dissipate. For this reason, the increase from 1.6 percent in January 2021 to 4.4 percent now is significant. And getting shelter inflation back to the 2 percent target range will not happen easily or quickly. Indeed, this January report is really a piece of economic history at this point. Yet this history indicates the serious efforts the Fed will have to undertake in the future to push back against the significant inflation momentum in the economy.

The final note about yesterday is the puzzle presented by the bond market. The yield curve in the bond market is the interest rate at various maturities – overnight, 3-month, 1-year, 2-year, 5-year, 10-year, 20-year and so forth. The overnight rate is essentially controlled by the Fed, so the "short" end is anchored by policy and one would expect that it would rise over the year as the Fed tightens and raises rates. But what happens to the "long" end?

If one expected inflation to continue, longer-term rates would have to rise to compensate lenders for the loss of purchasing power due to inflation. Alternatively, if one expected inflation to be controlled, the long end would remain anchored. Or, in the more extreme version, you might expect it to remain the same because the economy would be returning to the conditions that gave us zero interest rates to begin with: a recession.

The news on higher-than-expected inflation was accompanied by a flattening of the yield curve. Is this a vote of confidence in the Fed's ability to control inflation? Or is this the bond market screaming "beware: a recession is coming"? That is the puzzle *du jour*.